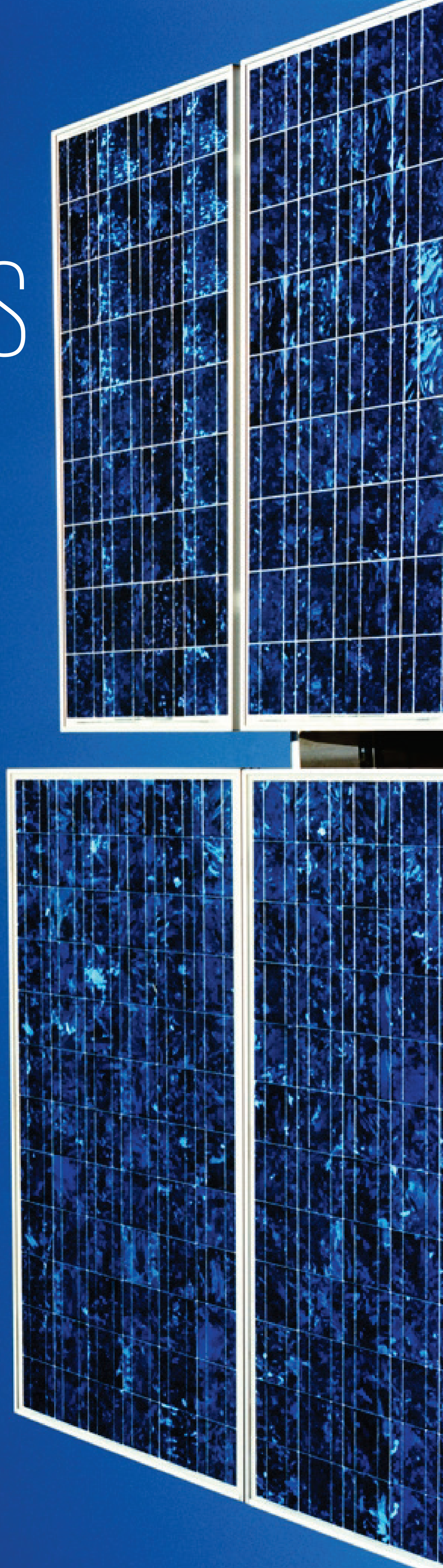
Saudi Arabia's Vision 2030

The Kingdom's plan for life after oil



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Saudi Vision 2030: Life after oil

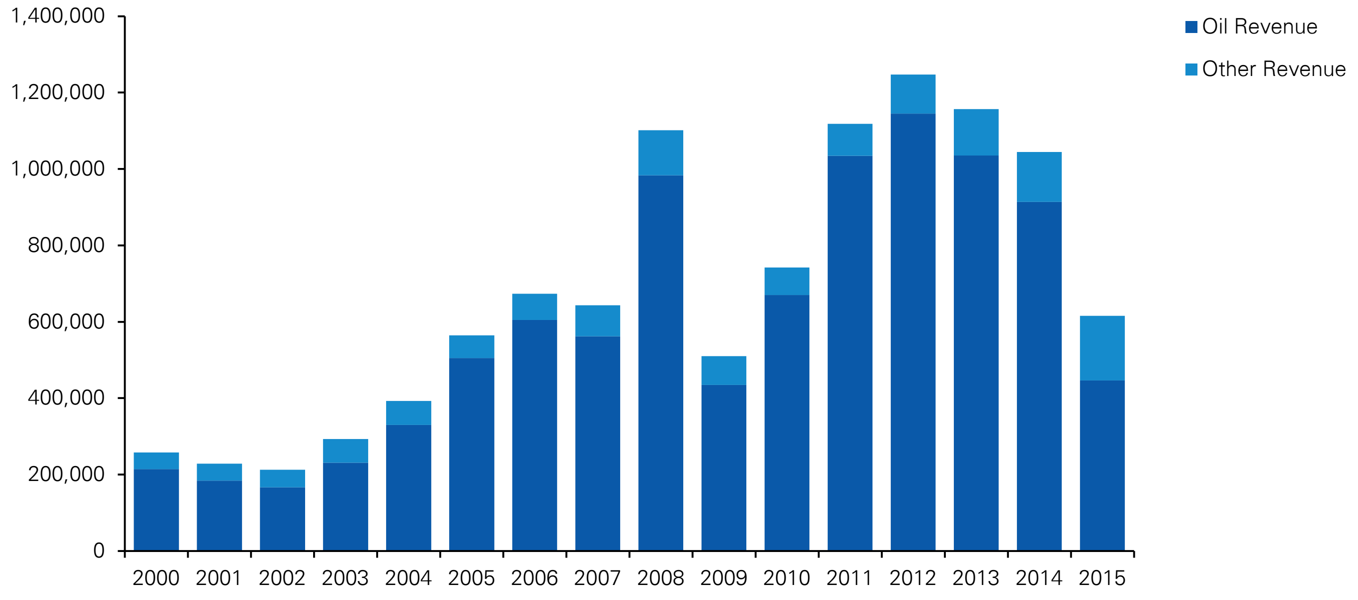
Saudi Arabia has launched an ambitious reform programme with Vision 2030, a long-term strategy to bolster the country's fiscal position and diversify its economy in a world of low oil prices. The strategy provides international firms with the opportunity to invest in the country, particularly in its non-oil sectors.

The strategy, approved by King Salman in early 2016, has made headlines for its plan to privatise at least five percent of the Saudi Arabian Oil Company ("Saudi Aramco"), the world's largest oil conglomerate responsible for approximately 12 percent of global production[a]. In a March 2016 interview, Deputy Crown Prince Mohammed Bin Salman, viewed widely as the main architect behind Vision 2030, stated his prediction that the privatisation would raise much of USD 2 trillion envisaged for the creation of a new sovereign wealth fund.

However the focus on Saudi Aramco's privatisation obscures the broader significance of Vision 2030 and how it is seeking to transform the country's economy. The vision of wholesale structural change adopted by the government does not come free of challenges but, if successful, will open up much of the Saudi economy to foreign investors for the first time. This brief looks at the context for this change, the initial reforms and challenges faced by the government, and some of the opportunities ahead.

Dependent on oil

Oil revenue as a ratio of total revenue, 2000-2015 in Saudi Riyals



Source: Saudi Arabian Monetary Agency, Annual Statistics 2016

Note: (a) http://money.cnn.com/2016/05/10/news/companies/saudi-arabia-aramco-oil-ipo/

"We used to be very selective about which sectors to privatise, where foreigners could invest… now the door has been swung wide open."

The context

The drop in global crude prices since 2015 has had a significant impact on oil exporters in the Gulf Cooperation Council ("GCC"), the majority of whom are heavily reliant on the revenue those exports generate. Qatar, Yemen, Oman and Saudi rely on oil revenues for over 75 percent of their national budgets, for example. That heavy reliance produced a combined budget deficit of USD 160 billion across the GCC in 2015. This was new territory for the region; for some context, countries in the GCC ran an average annual budget surplus of 12.2 percent from 2002-2011.

Saudi Arabia has been particularly hit by the new oil price. The country ran a budget deficit of USD 98 billion in 2015, equivalent to around 16 percent of its GDP, and USD 79 billion in 2016[(a)]. It has financed its deficit largely by drawing from its net foreign reserves, which have dropped over USD 200 billion since August 2014[(b)]. The country has seen its weakest rise in salaries in the last decade, and growth in 2017 is projected to slow to 0.4 percent[(c)].

The fiscal pressures resulting from the drop in oil price have brought with it increased scrutiny of the region's economic models, built around very low taxes, heavy subsidies and sprawling public sectors. As a senior Saudi banker told us, the sustained surplus has meant that the GCC has historically been very selective about reform. "We used to be very selective about which sectors to privatise, where foreigners could invest… now the door has been swung wide open."

Initial reforms

The early response to these pressures by the Saudi government has been bold. The government has begun gradually lifting subsidies on gas, electricity and water, and placed higher levies on tobacco and other harmful products[(d)]. To offset any potential stress from the lifting of subsidies, the government has plans to provide direct benefits targeted to lower and mid-income families. In March 2016 the government began an initiative asking all ministries to be more prudent in their spending, and we are aware that a programme has been put in place to increase spending efficiency across the government.

Investment opportunities

To relieve its budgetary pressures, the government has also sought to attract increased foreign capital. Plans to open the country's equity market have been fast-tracked, and the country held its first international bond sale in October 2016[(f)]. To incentivise investment in the country's non-oil industries, the government has created industry clusters, including a major automotive manufacturing cluster in Jubail.[(g)]

The government has also announced plans to fund large-scale infrastructure projects aimed at attracting foreign and private investment. Many of these projects will be run on a public-private-partnership basis, and will involve the privatisation of existing government entities:

- **Healthcare:** The government has earmarked USD 11 billion for investment opportunities in the sector by 2020, including opportunities in tertiary and secondary care, procurement and manufacture of medical devices, education and insurance.
- **Construction:** A pipeline of mega-projects, including an USD 8 billion expansion of rail services in the country and the construction of the USD 67 billion King Abdullah Economic City will require significant international investment.
- **Transportation:** In 2015, the Ministry of Transport set a 10-year expansion plan of its public transportation services, earmarking USD 90 billion for new metro lines and bus routes in Riyadh, Jeddah, Mekkah and Medina.
- **Renewable energy:** The government has allocated USD 1.33 billion for the construction of the King Abdallah City for Atomic and Renewable Energy, through which it aims to generate 3.4 GW of renewable energy by 2020.
- **Tourism:** Historically restricted to religious tourism, Saudi Arabia is looking to attract 1.5 million leisure tourists by 2020 through the easing visa restrictions and investment in hospitality projects. International companies such as the Rezidor Group and Accor have announced plans to open dozens of new hotels in the next five years.

(*continued on next page*)

Notes:
(a) https://www.bloomberg.com/news/articles/2016-12-22/main-features-of-saudi-arabia-s-2017-budget-2016-performance
(b) https://www.bloomberg.com/news/articles/2016-12-22/saudi-arabia-sees-budget-deficit-falling-to-7-7-of-gdp-in-2017
(c) https://www.bloomberg.com/news/articles/2017-01-16/imf-slashes-saudi-arabia-growth-forecast-on-lower-oil-production
(d) http://www.argaam.com/en/article/articledetail/id/444781
(e) http://uk.reuters.com/article/us-saudi-contracts-austerity-exclusive-idUKKCN0WG29U
(f) https://www.ft.com/content/c8d1bbe6-9478-11e6-a80e-bcd69f323a8b
(g) http://gulfbusiness.com/massive-automobile-manufacturing-cluster-open-saudis-jubail/

- **Wastewater and desalination:** As the government looks to increase its annual production of water to meet growing demand, it has allocated USD 60 billion for the development of wastewater and desalination plants.
- **Education:** The Saudi government has allocated USD 53 billion in its latest budget for investment in education, aimed at attracting significant private sector participation in the sector.

Although early reforms adopted by the government have been promising, the government is likely to face some challenges to implementing its vision, particularly as the cost of living increases. The lifting of subsidies and freezes on public sector hiring may weigh on the population, though plans to enhance the social safety net have been put in place to deal with any potential fallout. The government has also launched programmes to develop the skills of its workforce, and stimulate small and medium enterprise activity and private sector hiring.

Many of the government's projects will be run on a public-private-partnership basis, and will involve the privatisation of existing government entities.

GDP growth (2017 projected):	2.5%
Inflation:	2.6%
Unemployment:	12.1%
Population:	32.6 million
Foreign nationals as percent of population:	33%
Budget deficit (2017 projected)	9.5%

Sources: Bloomberg, Reuters, SAMA, Forbes

Navigating the opportunities ahead

Despite some early bumps, the road ahead for Saudi Arabia looks promising for international companies looking to enter the market. New opportunities in healthcare, construction and transportation are likely to attract significant attention and investment from European firms.

As companies enter the market, they will need to quickly familiarise themselves with its key sectors and stakeholders. In most cases, they will form partnerships with local companies and sponsors who will help them navigate the country's business scene.

A challenge that firms will face when considering doing business in Saudi Arabia is the relative lack of public record information and data available on the market and their potential local partners. KPMG's Corporate Intelligence team can gather intelligence to help you understand the market and anticipate any risks you may face.

Questions we regularly help clients with include:

— Who are the key stakeholders in your industry that you will need to build a relationship with? How are they likely to impact your business? What are their agendas and how closely are they likely to be involved in your business?

— Who is your business partner? What is their background and track record in the sector you are looking to enter?

— Who are your main competitors? How are they likely to perceive your entry into the market?

— What strategies do you need to have in place in order to deal with the operational challenges of doing business in Saudi Arabia?

— How have other local and foreign entrants to the market been successful in marketing and distributing their products?

For more information on how we may support you as you enter the Saudi Arabian market, contact any of our team members below.

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