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Reaching out

Saudi king unveils string of social benefits, debt write-offs

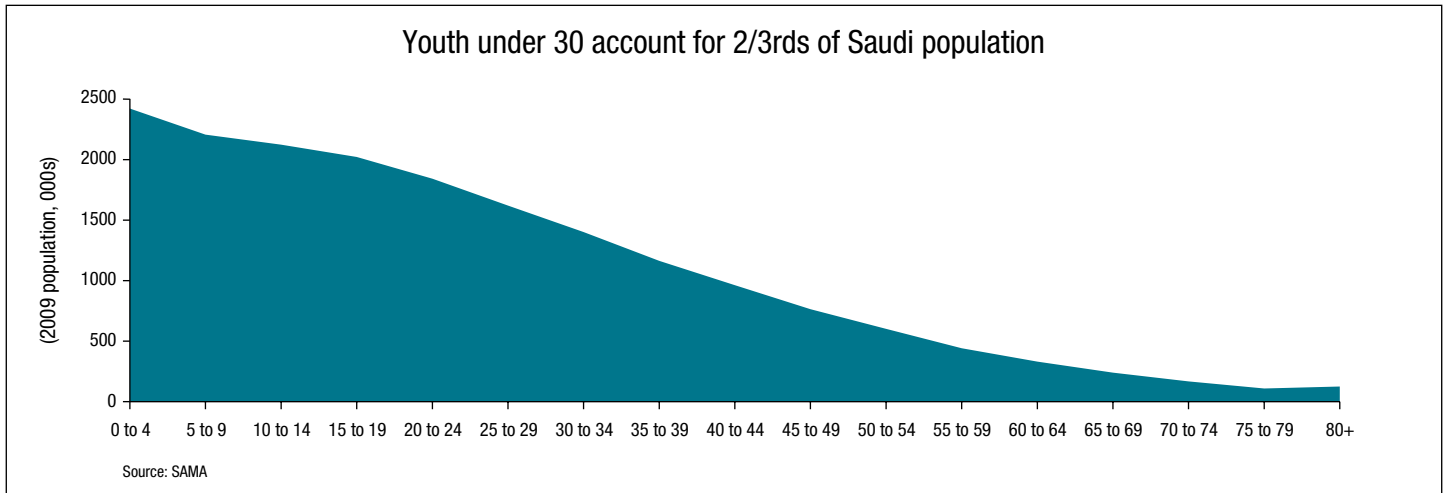
- **Saudi King unveils series of plans estimated to cost SR 135 billion to support citizens, housing, education**
- **Jobless Saudis granted for the first time one-year unemployment benefit**
- **King calls on state funds to write off loans of deceased and prisoners**
- **Hundreds of millions set aside for charities, sport and cultural clubs**

Saudi Arabia's King Abdullah unveiled on Wednesday a series of financial support measures – including a pledge to provide unemployed Saudis with financial support for one year and write off a series of loans – in an endeavour to support citizens as regional popular unrest acts as a lever for expediting crucial social and economic reforms. With U.S. oil prices reaching 2-1/2-year highs of more than \$96 a barrel and Brent crude climbing to more than \$106 a barrel this week amid a popular uprising in Libya, Saudi Arabia can comfortably finance social policies designed to ease the burden of high property prices and housing market imbalances, while helping its young population cope with a mounting unemployment challenge.

The king released a total of 19 orders on Wednesday which we estimate will cost the country about SR135 billion, according to our preliminary estimates. This is more than double a 2008 plan of SR66 billion, which had at the time been formulated to alleviate the impact of inflation at three-decade peaks on the population.

In new measures on Wednesday, the kingdom said it would introduce an unemployment benefit, the first of its kind in the kingdom, providing wages for one year to jobless Saudis searching for work. The government did not say how much each unemployed person would be eligible to receive, although we estimate it would involve a benefit of SR1,200-SR1,500 a month. As of 2009, there were 448,547 unemployed Saudis, for an unemployment rate of 10.5%. Youth stand to benefit the most from the scheme; joblessness among Saudis below the age of 30 was 27% in 2009, including some 39.3% of youth between the age of 20 and 24 without work.

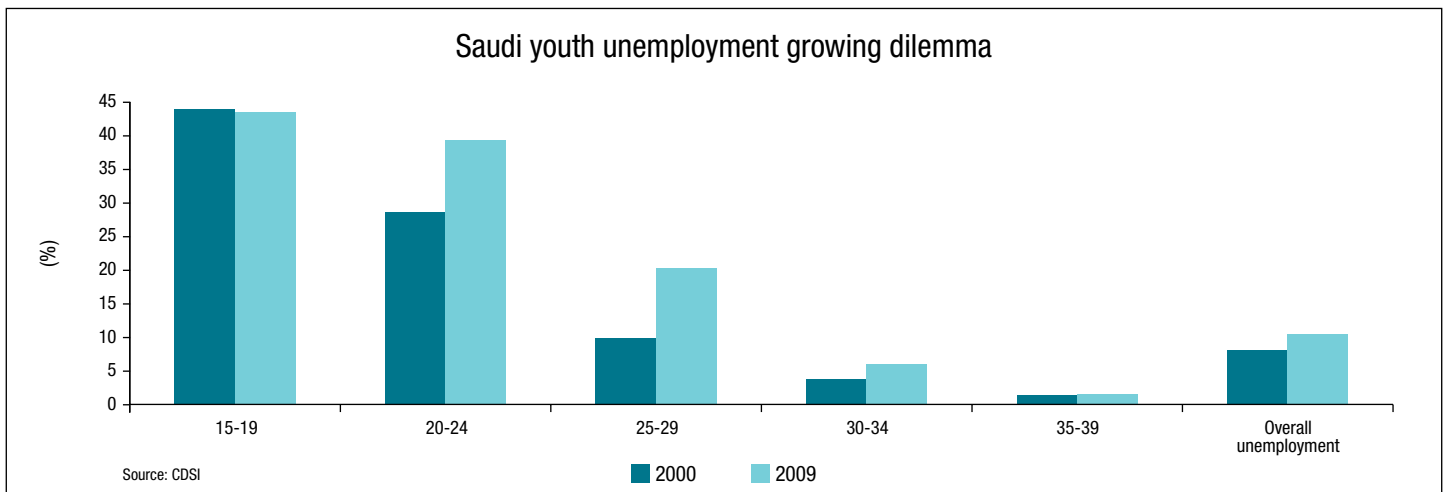
Another key feature of the royal order is a plan to admit all Saudi students studying abroad at their own expense into a state scholarship programme, lessening the burden on many medium- to high-income families. The King Abdullah Scholarship Program had up to now sent more than 90,000 high-achieving Saudis to pursue graduate studies abroad, applying specific performance criteria on recipients. The king also pledged to set aside SR100 million for students in need of financial support.

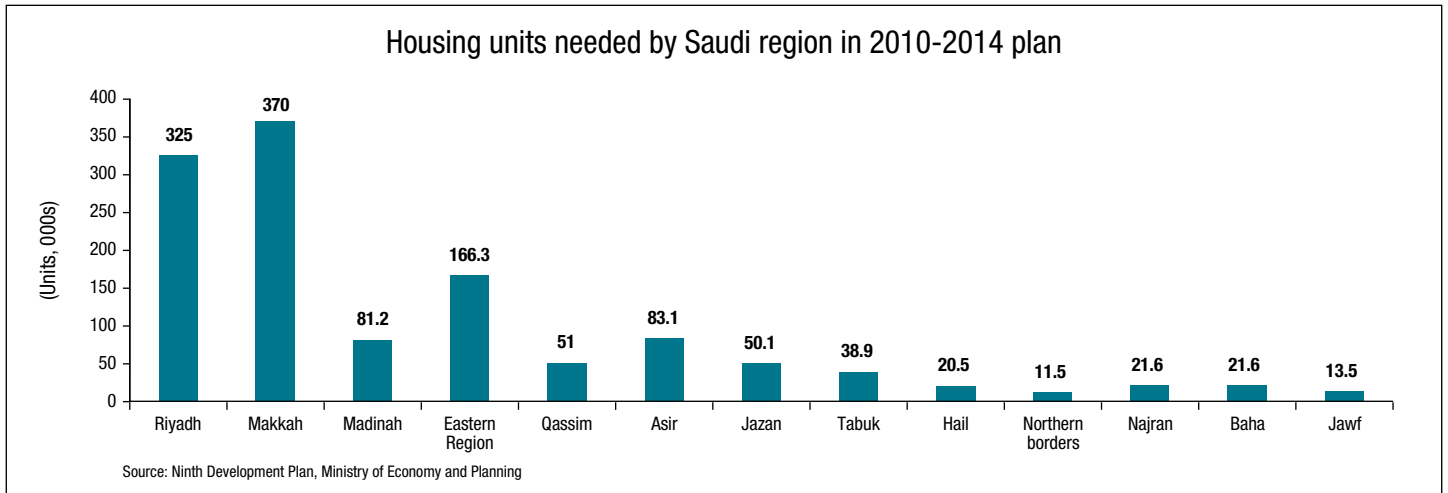


The country will, further, expand its social insurance security scheme to enable families to claim benefits for up to 15 members, higher than a previous cap of eight. We anticipate this benefit extension will cost about SR20 billion a year. As well, SR3.5 billion will be allocated to start a programme for supporting citizens' household expenses: home furniture, school uniforms and books, electricity and water bills, and home renovations. Homes of many Jeddah citizens suffered substantial damage following atypical flooding on a number of occasions in the past two years. Inflation in home furnishings averaged 2.9% in 2010, down from 8.6% a year earlier, while education expenses have risen in recent years, although the official education and entertainment inflation index rose only 0.9% in 2010.

Meanwhile, the government reiterated that it would not phase out an inflation allowance that had raised salaries of state employees by 15% over the last three years, an announcement first made in November. This allowance would become part of each employee's permanent salary under the royal order. Our estimates show the additional wage would cost about SR37 billion a year, raising the total wage bill to SR250 billion. As we have stated before, we do not expect this measure will stoke inflation as it has already been absorbed by the economy incrementally.

In light of the new expenditures and strong oil prices, we will review our fiscal forecasts, which currently foresee the country achieving a 2011 budget surplus of SR93 billion on expenditures of SR676 billion. Government expenditure allocations had been set at SR580 billion in December. Saudi Arabia held SR1.65 trillion (\$440.4 billion) in net foreign assets at the end of 2010, giving it flexibility to step up social spending. In addition, our oil revenue forecast of \$212.4 billion was based on an average oil price of \$82.5/barrel. U.S. crude has averaged \$89/barrel so far this year.





Writing off debts

In the wake of successful popular revolutions in Egypt and Tunisia, Arab governments have striven to allay concerns of their populations, particularly youth who, in the case of the kingdom, face double-digit unemployment rates as inflation remains historically high and housing costs escalate beyond the reach of most of the middle class. As part of the Saudi plans, the King ordered that 300 jobs be created in the Saudi Royal Court “to communicate with citizens and find out their needs”.

The king raised the General Housing Authority’s budget by SR15 billion, while the Saudi Real Estate Development Fund (REDF) gets a SR40 billion capital injection – a move we expect will shorten the estimated 18-year waiting period Saudis face to qualify for a loan due to pent-up demand. He reiterated that the kingdom would ask REDF to write off outstanding loans of borrowers who had passed away. Earlier this month, the government said it would have REDF write off SR585 million worth of housing loans granted to 3,276 people who died after Sept. 11, 2007, relieving the debt burden on their families. It is unclear whether the announcement on Wednesday would extend this debt relief plan to a greater number of surviving family members. In REDF’s first 25 years since inception, 22,000 housing units were build yearly. We estimate there is an annual need of more than 230,000 housing units each year.

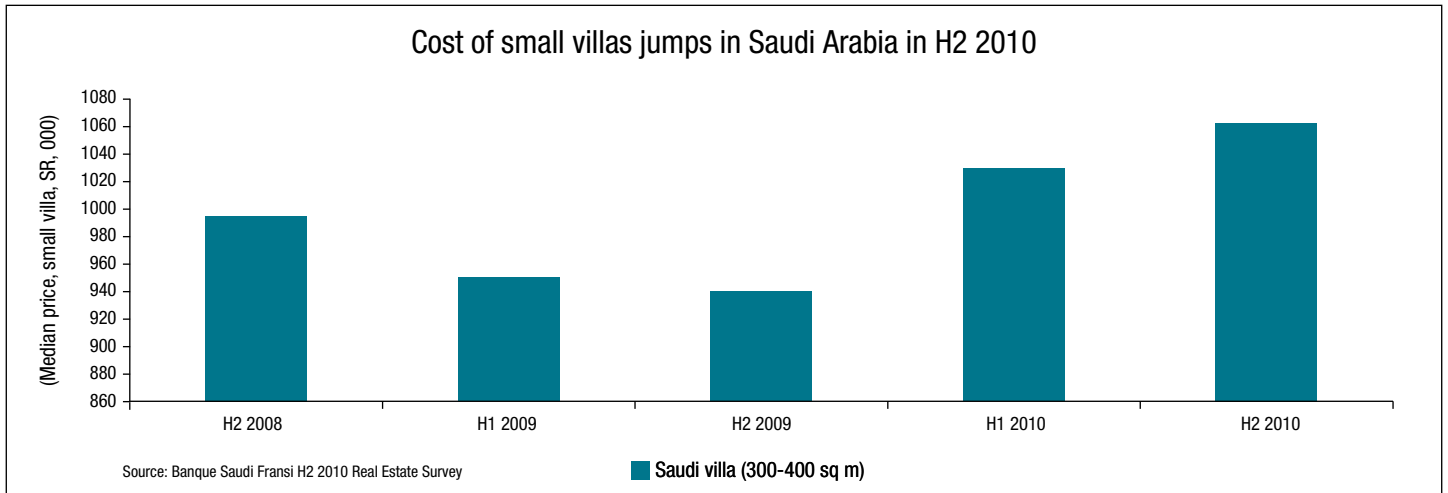
The government further plans to inject SR30 billion of capital into the Saudi Credit & Savings Bank, one of several specialised credit institutions, including REDF, operated by the Saudi government. The bank would also be asked to forgive some debts of Saudi borrowers who had passed away, according to the royal order. A large number of prisoners would also have their debts forgiven and the order indicated that prisoners would be released “under certain guidelines”.

The king, meanwhile, seeks to provide greater support to cultural and sporting institutions by, for instance, raising subsidies offered for sports clubs and providing SR10 million to each professional committee and cultural club in the country. Among other charity-related promises made are pledges to:

- 1- Increase funds allocated to the charity association by 50% per year to SR450 million
- 2- Support cooperative associations with funding of SR100 million
- 3- Allocate SR100 million to the National Charity Fund

Will it be enough?

The initiatives announced on Wednesday appear to target a comprehensive range of concerns among Saudi citizens and lend support particularly to those in lower income brackets who would benefit tremendously from an expansion in social security benefits. The government made firm calls for housing projects to be accelerated and REDF to speed up its lending process. The government must continue to make targeted efforts to entice and support those most in need of assistance.



Offering financial support for unemployed youth is a step in the right direction, although as we argued in a report last week entitled “Employment Quandary”, jumpstarting private sector job creation will be the key to resolving the unemployment dilemma. Currently, only one out of every 10 employees working for a Saudi private sector company is a Saudi citizen. The public sector can no longer act as the employer of last resort for Saudis. Saudi Arabia has to exit from the comfort zone of offering low-paid and low-incentive public sector employment.

The urgency to improve this situation is apparent – the king called for the formation of a committee of ministers to study the unemployment problem and report to him within four months. The king said the government would spur creation of 1,200 new jobs to support regulatory programmes, including 300 jobs for each of the Saudi General Auditing Bureau, Saudi Control & Investigation Board, Saudi Bureau of Investigation and Prosecution and Saudi Royal Court.

Still, while preliminary labour ministry estimates indicate unemployment fell to 10% in 2010, we expect the rate will rise to 10.7% this year and 10.9% in 2012. As we argued earlier this month, relying on cheaper expatriate labour, and hence creating a low wage equilibrium environment, stifles Saudi entrepreneurship and productivity. It remains to be seen if the reforms will rectify comparatively low Saudi labour force participation of 36.7%.

It is also unclear whether unemployment benefits will be coupled with job searching facilities to reduce the risk of manipulation and avoid creating a new class of unemployed beneficiaries. One way to avoid dependence on benefits would be to have them progressively decline as time passes so as to entice labourers to find employment.

Resolving a housing market dilemma is also crucial. The cost of housing in the kingdom has spiralled in recent years due to inadequate supply, which the state aims to rectify in the coming years through the construction of 200,000 new housing units per year through 2014. Rental inflation, while it has halved, remains near 10% and sale prices for properties have risen quickly in the past year. Our H2 2010 Saudi real estate survey showed villa sale prices jumped across the country, including median gains of 19% for small villas in Riyadh and 17% in Jeddah, compared with H1 2010.

The measures taken this week are on the right track toward addressing economic desires of Saudi citizens, however the government will need to continue gauging popular sentiment as citizens across the region seek political reforms and development of civil society institutions. Challenges this year will involve tackling head-on key economic concerns, most prominently, employment generation, housing, the rising cost of living and moderating disposal incomes.

Disclosure appendix

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- 2 - All market data included in this report are dated as at close 23 February 2011, unless otherwise indicated in this report.
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