Global Asset Management

Saudi Arabia: a new world?

Notes from the road

Emerging Markets Equity team

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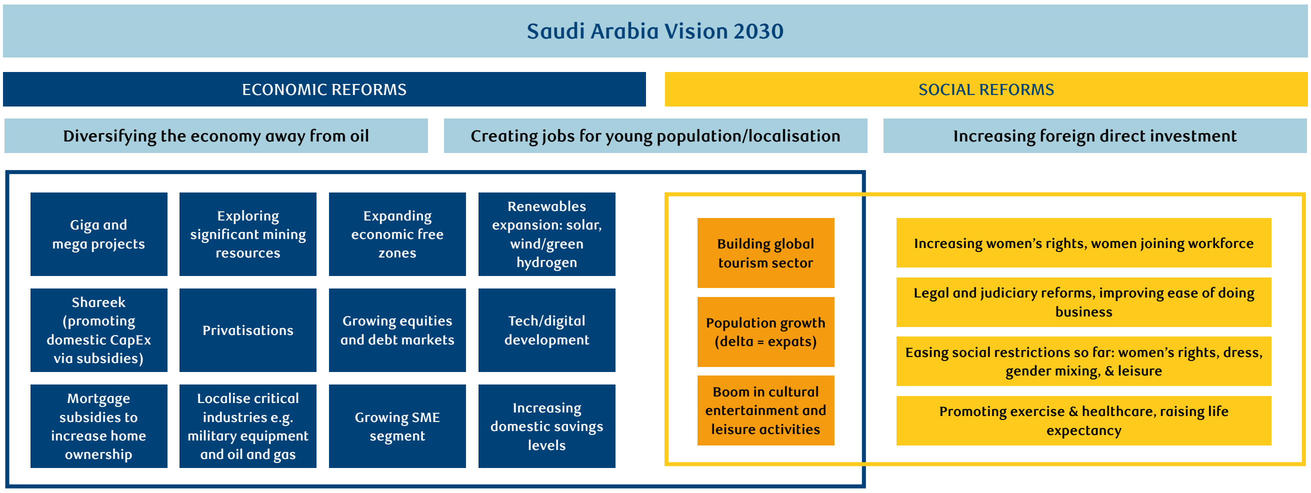
"Are you even allowed to travel there as a woman?" and "Will you have to wear an abaya[1]?" These were some of the questions asked when I mentioned I was finally visiting Saudi Arabia, a long overdue trip to the largest of the Gulf Cooperation Council ("GCC") countries, which also include the UAE, Kuwait, Bahrain, Qatar and Oman. Despite being aware of the transformation the country has undergone over the past few years, I was also unsure and wondered if the changes would be real and visible.

My first contact in the capital, Riyadh, was with the friendly female border control officer at the modern and efficient airport. She didn't have her face covered and warmly welcomed me to the country when she learned it was my first visit. During my four-day trip, every person I met in the hotels, shops and company visits was equally welcoming. I wore western clothes and noticed that many women were now wearing colourful robes and simply had their hair covered.

Arriving at Riyadh airport.

[1] An abaya is an outer garment worn by women in some parts of the Middle East, particularly Saudi Arabia and the Arabian Gulf region.

Exhibit 1: Saudi Arabia Vision 2030



Source: Morgan Stanley Research, as at December 2022.

In fact, the abaya was only made mandatory in 1979. Before then, Saudi Arabia followed moderate Islamic policies and was moving towards a western model of consumerism as it grew richer and more urbanised. The turning point was the Mecca attack in 1979 when a group of extremists, unhappy with the new direction the country was taking, killed thousands of pilgrims. The reaction of the ruling family was to implement a stricter version of Islamic law and to give more power to the religious doctrine.

"In terms of economic reforms, the plan looks at diversifying the economy away from fossil fuel by notably developing non-oil exports."

Changes began under the previous King Abdulaziz but have accelerated since HRH Prince Mohammed bin Salman ("MBS") became Crown Prince in 2017 and effectively took over from his father, King Salman. MBS is currently the Prime Minister, Chairman of the Saudi Council of Economic & Development Affairs and the driving force behind the changes in the country over the past few years.

A controversial figure, MBS is seen as a reformist on one hand but has also been accused of running an authoritarian and repressive regime on the other. Nonetheless, he has been able to embark on a rapid succession of reforms under the banner of the Vision 2030 plan (Exhibit 1). The Crown Prince announced that the "country is returning to what we were before — a country of moderate Islam that is open to all religions and to the world"[2].

The Vision 2030 plan includes both economic and social reforms. On the social front, many changes have already happened and are far reaching, from women's rights to promoting exercise and wellbeing.

In 2017 the ban on cinema was lifted, while in 2018 MBS announced that abayas were not mandatory anymore and that it was sufficient for women, in parallel with men, to wear decent and respectful clothing. Women were also allowed to drive from that year. Since 2019, music can be played in restaurants, and from 2021 women were allowed to work, live and travel on their own without the permission of a male relative.

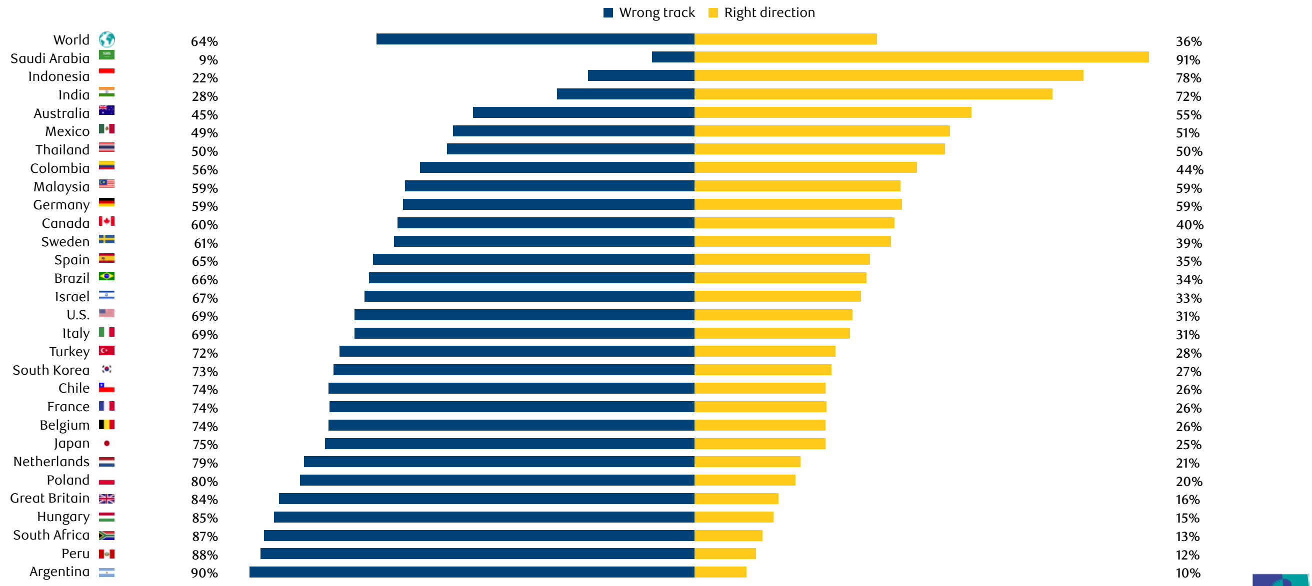
In terms of economic reforms, the plan looks at diversifying the economy away from fossil fuel by notably developing non-oil exports, localising the production of key industries, deriving 35% of GDP from SMEs, and developing entertainment activities, as well as local and foreign tourism, to 10% of GDP from a current 3.6%[3]. The target for tourism is particularly ambitious, as the country looks to become one of the top five destinations in the world, thanks to both religious and leisure visitors. For instance, in the Red Sea, the plan is to build 50 luxury resorts with prestigious global hoteliers. The first one, Southern Dunes, part of the Six Senses luxury resort brand, was opened in October this year.

Six Senses' Southern Dunes hotel in the Red Sea.

[2] Saudi Arabia (arabnews.com/node/1371221/saudi-arabia).
[3] Morgan Stanley Research, December 2022.

Exhibit 2: Saudi nationals fully embrace the changes

Would you say things in this country are heading in the right direction, or are they off on the wrong track? (November 2022)



Base: Representative sample of 20,466 adults aged 16-74 in 29 participating countries, October 21st 2022 – November 4th 2022.
Global score is global country average.

Source: '[What worries the world?' (ipsos.com/sites/default/files/ct/news/documents/2022-12/Global%20Report%20-%20What%20Worries%20the%20World%20November%2022.pdf).](ipsos.com/sites/default/files/ct/news/documents/2022-12/Global%20Report%20-%20What%20Worries%20the%20World%20November%2022.pdf)

Vision 2030 details eight giga projects, including building entire new cities for a total spend of USD1 trillion[4]. To finance this plan, the country is opening to foreign investment, notably through privatisation and reforms in its equities and debt markets.

Talking to management of businesses in the country, they highlighted another set of key reforms which took place in 2021 and 2022: judicial reforms, which effectively created a framework away from Sharia law and created a consistent set of rules, reliable procedures and codification of laws. These reforms are crucial for the development of a strong private sector and in order to attract investment.

"We spoke to young Saudis who told us that their country today is completely different from even five years ago."

Several polls have shown that the modernisation of Saudi society is supported by an overwhelming majority of the country's nationals. As we were told by a CFO during our trip, the floodgates have been opened and the population is greatly embracing the positive changes. A CEO joked that older people are thinking about suing the government as they have missed out!

Saudi Arabia topped dozens of other countries in a poll by Ipsos at the end of 2022, which showed that 91% of citizens believed that the country was heading in the right direction (Exhibit 2).

Interestingly for us as emerging markets equity investors, two other developing countries sat at the top of the leaderboard: Indonesia (78%) and India (72%). North America and Europe trailed behind, with the U.S. at 31% (meaning that 69% of the population thinks the country is getting worse) and the U.K. at 16%, near South Africa and Argentina. Inflation, poverty, and inequality, as well as crime, were cited as the main worries by those who participated in the survey. This positive direction of travel was reinforced when we spoke to young Saudis who told us that their country today is completely different from even five years ago.

Evening entertainment in Saudi.

[4] National Investment Strategy - (vision2030.gov.sa/en/explore-more/national-investment-strategy/).

“Four Special Economic Zones were announced in April 2023, with the goals of localising supply chains and creating jobs locally.”

The top three universities in Riyadh are mixed, and the stated goal is to help women achieve an equal footing in society. At present, Saudi women comprise 34% of the total workforce. Five years ago, it was only 17.4%[5]. This compares to 41% today in Italy, for instance. 60% of employed Saudi women have started to work in the past two years and 60% of those still unemployed plan to work in the next two[6].

Women are also encouraged to work to help the ‘Saudization’ of society, another key goal for MBS. As the country has grown richer, thanks to oil revenues, an increasing number of jobs have been filled by expatriates willing to work longer hours for lower pay. Of the 36 million inhabitants, 42% are non-Saudi, with the largest group of foreigners coming from Bangladesh, India, Pakistan, and Yemen. We expect the expat population to change, with more white-collar workers moving to the country (especially from developed markets), in order to take advantage of the opportunities created. Four Special Economic Zones were announced in April 2023, with the goals of localising supply chains and creating jobs locally. They are aimed at multi-national corporates with multi-year tax holidays, subsidised energy prices, supportive regulation to attract and retain foreign talent and, crucially, 100% foreign ownership. We spoke to a business owner during our trip – the company is currently headquartered in Dubai but is undertaking an increasing number of projects in Saudi Arabia. He is even currently considering moving the company’s headquarters to Riyadh, in order to benefit from the tax advantages and the proximity to his customers.

Vision 2030 aims to grow the population at 4.4% CAGR to close to 50 million by 2030. A larger, more diverse population with higher incomes will drive an increase in consumption habits for both services and goods. The population is young, at an average age of 30 years, and urban, as 85% of habitants live in cities[7]. Indeed, a recent survey by JPMorgan Research found that 98% of Saudi nationals plan to increase spending in the coming 12 months, with a focus on education, tourism & travel, food and general merchandise.

Our visit to Riyadh showed a city under construction. Every second plot of land is full of cranes. However, we have yet to see a significant modernisation of the city. We could sense though that changes are coming fast and that the population is very excited about a modern Saudi Arabia. During our stay, we visited one of several large entertainment resorts which have opened in the past few years. It had dozens of shops, restaurants, cinema, a lake with water fountains, huge screens, and laser shows. On a Tuesday evening the venue was packed. Riyadh seems quiet during the day, apart from heavy road traffic, notably due to the heat and the fact that people drive everywhere, but we saw that the city comes alive at night.

In addition to meeting some of the largest corporates in the country, we met with the Public Investment Fund (“PIF”), the government arm in charge of financing the Vision 2030 initiatives, currently responsible for USD700 billion of assets. In fact, PIF wanted to meet with us, as a large investor in emerging markets, as it was keen to hear our views on how it could improve the attractiveness of the companies it has invested in and is now privatising, in order to fund new projects. We had a frank discussion where we highlighted that transparency, quality of disclosures and empowering strong independent managements are key for us.

Riyadh under construction.

5 IMF, December 2022.
6 Morgan Stanley Research, December 2022.
7 [Saudi Arabia (KSA) population statistics 2023 (globalmediainsight.com/blog/saudi-arabia-population-statistics/#Saudi%20Population%202023%20%E2%80%93%20Key%20Statistic).](globalmediainsight.com/blog/saudi-arabia-population-statistics/#Saudi%20Population%202023%20%E2%80%93%20Key%20Statistic)

We came back from this trip feeling positive about the large potential for growth, and we could sense how much the country has already changed. However, there are still many hurdles along the way to reach the ambitious goals set up by the Crown Prince. The main risk for the country is a sudden change in leadership which could lead to a return to a more socially conservative society as well as halting the Vision 2030 project. A collapse in the oil price would also be a challenge for the financing of the government's giga projects. Currently Saudi Arabia's fiscal breakeven oil price is around USD80[8], and a lower oil price for a prolonged period would mean a reassessment of the ambitious plans. Execution risks are high; we have seen in the past that building rapidly large infrastructure tends to be delayed and we can't exclude the risk of the same happening in Saudi Arabia.

Finally, despite the recent changes, Saudi Arabia remains lowest ranked when it comes to ESG and human rights, and many investors want to see more progress before meaningfully adding to their exposure to the country. We too are currently assessing ways to gain exposure to the expected strong economic growth. However, most companies don't yet meet our criteria when it comes to the quality of management and franchise, disclosure and transparency, and the durability of business practices. Saudi is on the right path and hopefully the positive changes we are seeing will continue. Leaving Saudi, I found myself already thinking about my next trip to this fast-evolving country.

[8] IMF estimates.

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Laurence is Portfolio Manager & Deputy Head of Emerging Markets Equities at RBC Global Asset Management (UK) Limited. Prior to joining the firm in 2013, she headed the emerging markets team of a leading U.K. asset manager. In this role, Laurence was responsible for managing Asian and global emerging market income strategies, and developing quantitative stock selection and environmental analysis models. She began her investment career in 1998 as a quantitative analyst at a major financial services company, where she supported European and global equity portfolio management by developing quantitative models to assist in the portfolio construction and security selection process.

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