



The 2020 Vision of Saudi Arabia's Vision 2030

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Executive summary

The early modern Kingdom of Saudi Arabia derived the greatest portion of its income from taxes relating to religious tourism (the Hajj to Mecca and Medina). Saudi Arabia's income stream proved vulnerable in the wake of the Great Depression, where pilgrimage appetite declined precipitously. This highlighted the Kingdom's need for an alternative source of wealth. Simultaneously, World War I had spotlighted the importance of hydrocarbons in future industrial development and military efforts¹. Perceptively, the ruler and founder of the modern Kingdom, King Abdulaziz bin Abdul Rahman, initiated Saudi Arabia's commercial exploration for oil.

The upstream effort proved fruitful on 3rd March 1938, when a team from Standard Oil of California struck black gold in the desert bordering the Persian Gulf, establishing the Dammam oil well No. 7. The discovery was the beginning of a string of discoveries that signalled the beginning of an oil-focused economy, with the Kingdom later founding the Ghawar mega field in 1948, the largest crude oil source in the world, constituting approximately a third of Saudi's cumulative production today.

Today, Saudi Arabia is undergoing yet another pivotal economic and social evolution. To support its ambitions, the Kingdom has begun to tap private and public markets for capital. Avenues for raising capital have included conventional debt markets, and the issuance of Sukuk- Sharia-compliant Islamic financial obligations.

Saudi Arabia has been recently reappraised by several development institutions, seen its long-term sovereign credit rating ameliorate and maintained resilience of the US Dollar-pegged Saudi Riyal (SAR), which has been supportive of domestic and foreign investor confidence.

The regime of change brings with it a shift in perspective and an emphasis on key focal points for the Kingdom through the ambitious 'Vision 2030' blueprint. The iBoxx Tadawul SAR Government Sukuk Index serves as a transparent benchmark and will provide exposure to the structural evolution of Saudi Arabia to a more dynamic market, as the Kingdom seeks to:

- Ascend the hydrocarbon value chain and develop local non-oil industry,
- Leverage its benign demographic structure,
- Open up to global tourism and;
- Grow an international portfolio of strategic assets

Outline This paper will begin by reviewing the performance of the index, the underlying market and the prevailing macroeconomic conditions since inception, one year ago. This will be followed by an evaluation of the market's term structure, and an exploration of the structural thesis relevant to the credit story, underpinned by 'Vision 2030'. The Kingdom's framework for future growth and key focal points will be articulated, introducing the now broader family of indices as an instrument in the investment ecosystem for benchmarking the Kingdom's sovereign debt market.

1 Yergin, D., 2011. The prize: The epic quest for oil, money & power. Simon and Schuster.

Year in Review

Since its inception in June 2019, the total return index of dollar-pegged Saudi Riyal-denominated, Government-issued Sukuk has outperformed the broader market of A-rated² unhedged and dollar-hedged locally-denominated sovereign debt.

The launch of the index coincided with a reversal of the Saudi Arabian Monetary Authority's (SAMA) policy trajectory. Following a decade of stagnant repo rates and four successive hikes initiated in early 2018, the dovish sentiment became more prominent and SAMA aligned with central bank policy across the globe, making some 200bps in repo rate cuts over the past year (from 3.0%, to 1.0% currently) through three key rate cuts. Of the cuts made, 125bps could be attributed as a COVID-19 response (cited as a provision for 'preserving monetary stability given evolving global developments' in the authority's public communique).

Following three quarters of benign performance across the Kingdom's yield curve, market fears calcified surrounding the spread of coronavirus as lockdown measures were enforced and the spread of contagion stoked tumult across asset classes. The crisis brought into question the role of fixed income as a 'safe haven' (where 'high quality' bonds are inversely correlated to equity markets during times of crises) amidst a global 'dash to cash'. This phenomenon carried into Saudi Arabia's markets, causing the sharp drawdown in the index during March.

The market resumes flight

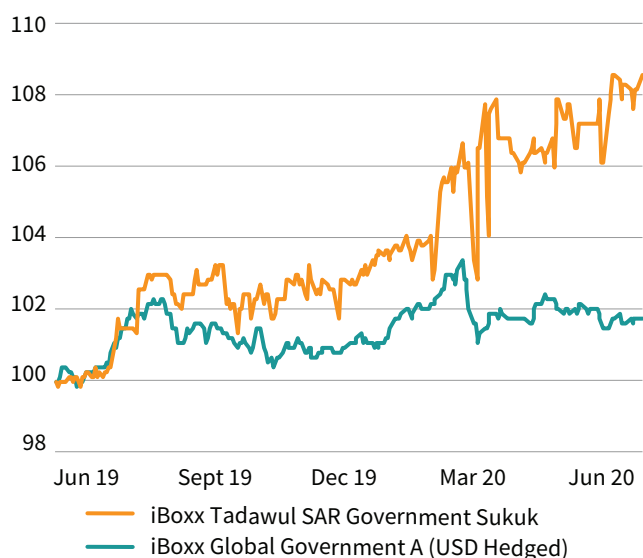


Figure 1 IHS Markit (rebased to 30/06/2019)

Sovereign fixed income 'safe haven' status disrupted globally (Total Return Indices, Jan-99 = 100)

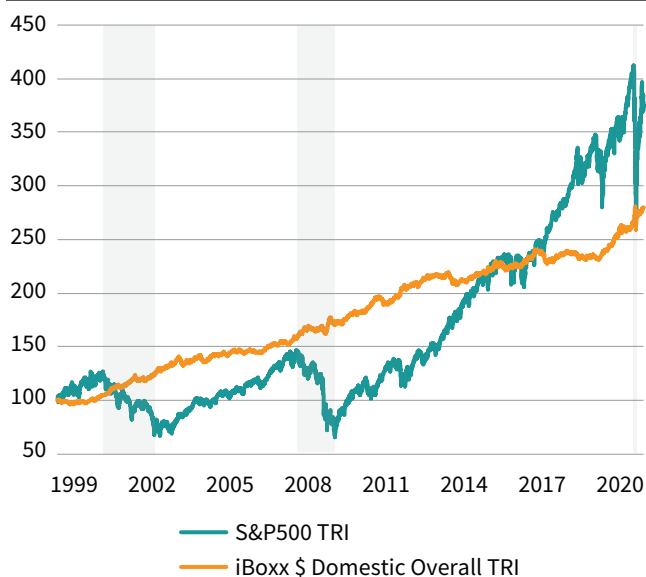


Figure 2 S&P Global, IHS Markit

US Bond and Equity Market Correlation

Downturn	Dot-com Bubble (2000)	Global Financial Crisis (2008)	COVID-19 Pandemic (2020)
Correlation	-95%	-66%	32%

² iBoxx Average Rating, derived from ratings from Fitch, S&P and Moody's, where available

For Saudi Arabia, 2020 brought about a three-pronged crisis:

Pest control. Locust infestations disrupted the natural pattern of religious migration and pilgrimage activity.

Lockdown. The spread of the coronavirus brought with it the cancellation of the G20 Riyadh Summit (primed to be a platform for Saudi Arabia to exhibit its social and civic development to the international community), and provoked an economic stagnation as lockdown measures were unveiled across the region, weighing on consumer and industrial activity.

Oil price shock. The nature of the economic crisis resulted in sectors most exposed to geographical mobility being disproportionately impacted, which magnified the immediate impact to the Kingdom's finances, which are sensitive to the energy commodities market. The crisis period was a test of Saudi Arabia's efficacy of diplomatic liaison, international leadership as the de facto leader (and founder) of OPEC and tactical toolkit in addressing large-scale health crises.

Incumbent head of the Saudi Arabian Ministry of Energy, H.E. Prince Abdulaziz bin Salman Abdulaziz Al Saud, has been instrumental in providing support for energy markets through his co-ordinated effort with the American and Russian envoy to curtail global output and through the enforcement of strict discipline on the OPEC member countries to ensure the defined cuts were adhered to. The effort has been testament to the Kingdom's commitment to diplomatic rapprochement and its role as a stabilising agent.

IHS Markit estimates remain constructive on energy prices in the medium-term.

Perhaps drawing upon experiences from the MERS-CoV epidemic, the Kingdom was able to leverage novel research and a capacity to rapidly deploy testing protocols to manage the spread and development of COVID-19. Responsive regulation from the Saudi FDA and Ministry

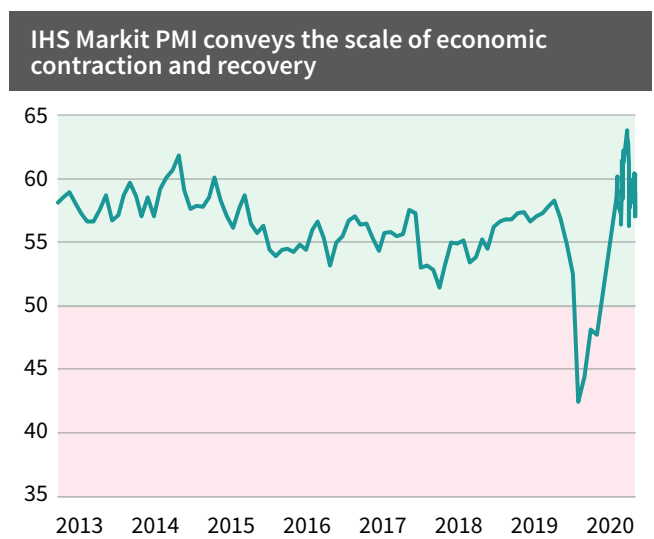


Figure 3 IHS Markit

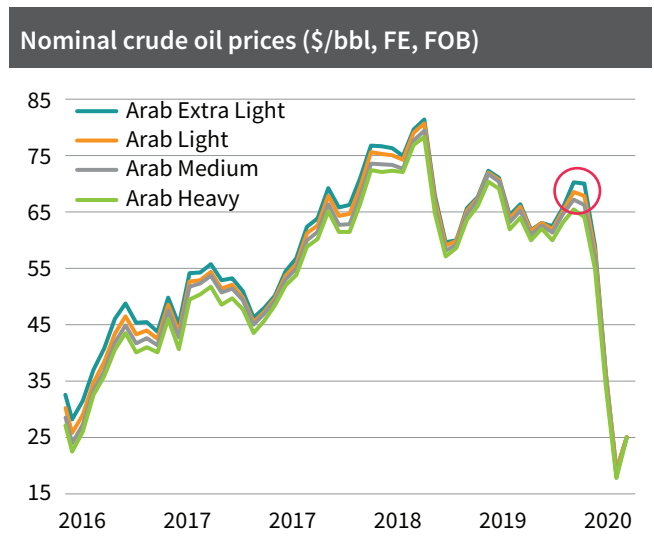


Figure 4 Argus Media Limited, IHSME

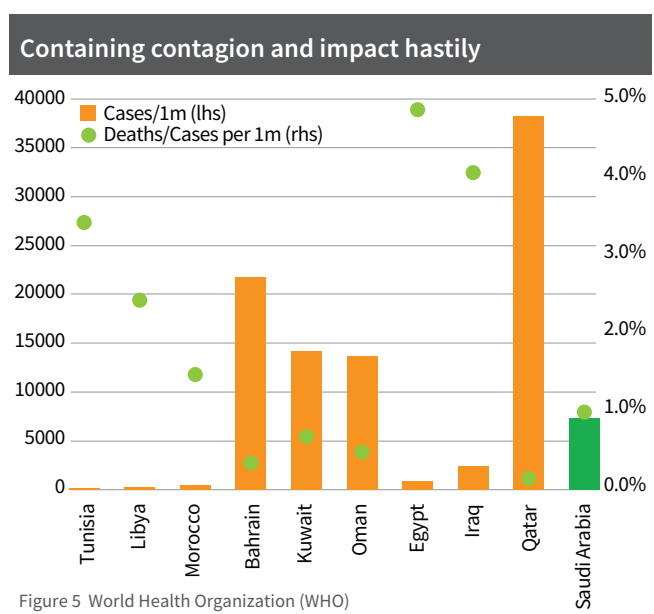


Figure 5 World Health Organization (WHO)

of Health also bolstered the effort, resulting in more effective pandemic containment than seen during the MERS-CoV outbreak³.

Whilst differences in data-gathering methodologies place limits on inter-country data comparability, based on the reported statistics, Saudi Arabia seems to have been able to contain the virus spread and the mortality rate effectively, relative to geographical peers in the Middle East and North Africa.

The Kingdom of Saudi Arabia’s Government Sukuk market, in-line with the broader narrative, experienced a deep but short-lived market sell-off, however the index recovered within three months (peak-nadir-peak). This pace of recovery was not experienced across all geographies, with the broad iBoxx Global Government Overall Index yet to recover to pre-crisis heights.

Early and effective intervention from the government and the central bank restored bond markets to their pre-crisis trajectory and tended currency markets back to their historical range bounds. Tough fiscal discipline (the trebling of value-added tax and the curtailment of public spend) helped to shore up capital buffers and to reduce the fiscal breakeven oil price (as reflected in the IMF’s annual projections).

“Together we are stronger. Together we can restore stability to oil markets and help rebuild the global economy”

Prince Abdulaziz bin Salman Al Saud
Minister of Energy

Orthodox monetary policy and sterilised intervention bring resolve to markets

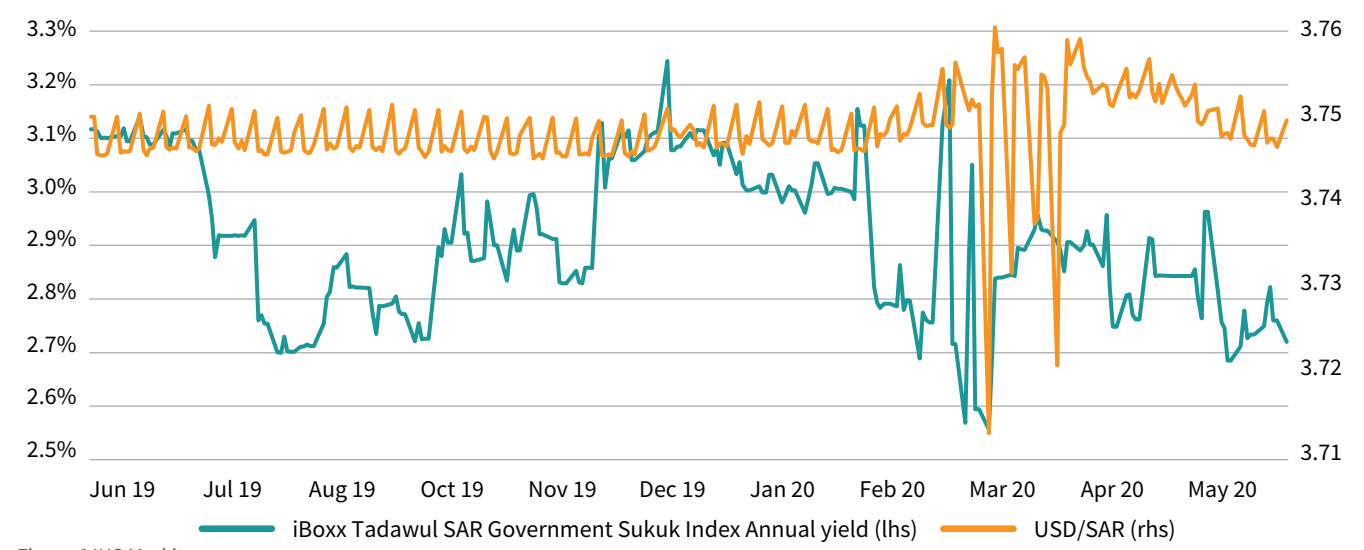
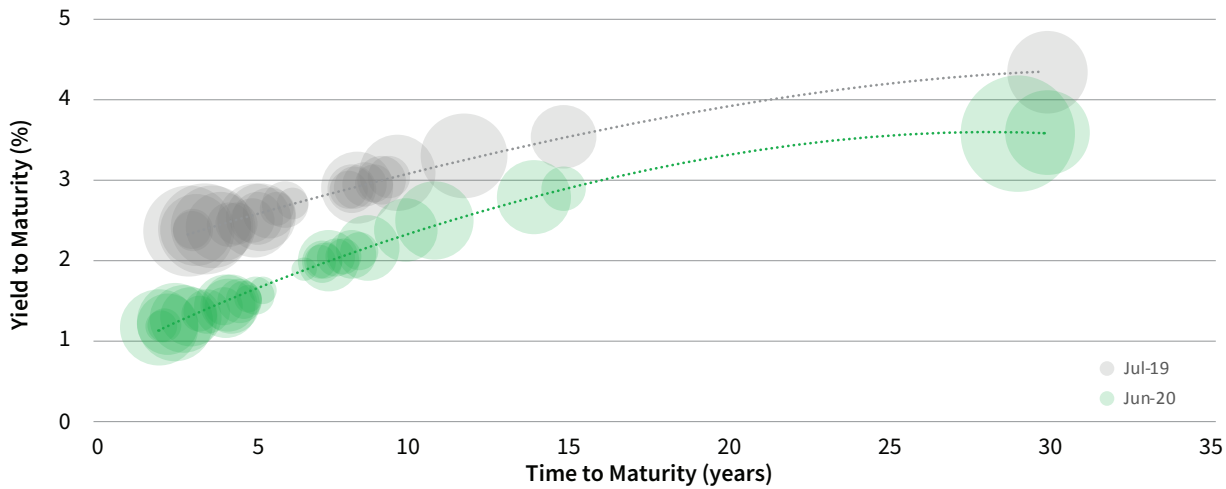


Figure 6 IHS Markit

³ Algaissi, A.A., Alharbi, N.K., Hassanain, M. and Hashem, A.M., 2020. Preparedness and Response to COVID-19 in Saudi Arabia: Building on MERS Experience. Journal of Infection and Public Health.

Index Profile

Yield Curve



Annual Yield (%)

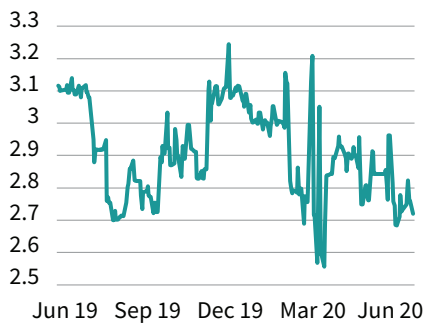
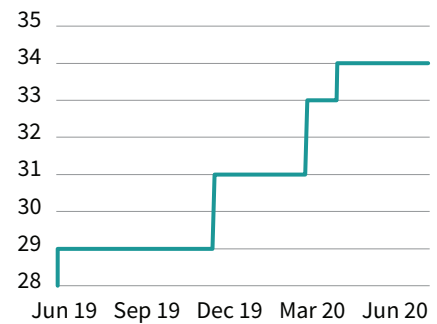


Figure 7 IHS Markit

Duration (years)



Number of Bonds



As the year unfolded, we observed a blend of greater foreign capital inflows and monetary easing build up demand in the existing Saudi Government Sukuk issuances, mechanically compressing yield across the curve and causing a downward parallel shift. The curve structure was more-than-proportionally impacted at the fringes, inducing a greater degree of curvature. The index coverage has grown (5 inclusion, 0 exclusions), as the Kingdom tested investors' appetite for new issuances, notably with a sizeable 30yr issuance and a 15yr issuance (whose pricing reflected a healthy issuance window despite an unfavourable global backdrop).

ISIN	Coupon	Market Value (SAR)	Issue Date	Maturity Date
SA151G0IIIJ5	3.68%	15,375,954,742	30/03/2020	30/03/2050
SA15100III31	3.00%	4,094,059,972	24/02/2020	24/02/2035
SA150G0IIHJ8	2.47%	1,279,699,720	27/01/2020	27/01/2027
SA14T00IIH32	2.69%	8,640,214,556	23/03/2020	23/03/2030
SA14T00IIGJ0	2.17%	2,841,734,927	23/03/2020	23/03/2025

The last twelve months have seen the index coverage profile bolstered. The curve has been extended and the new bonds have continued to fill the gaps across the maturity spectrum.

The Structural Story

Introduction

The modern Kingdom of Saudi Arabia celebrates its 88th anniversary this year. It is a cornerstone exporter of oil (possessing a quarter of proven oil reserves globally and c. 70% of global spare production capacity) with ambitious plans to open up and diversify its economy.

Saudi Arabia will seek to encourage further social and commercial development, undergoing a new phase of economic evolution. The blueprint for the Kingdom's economic and governmental reorganisation was defined by Crown Prince Mohammad Bin Salman Al Saud in his 'Vision 2030' and accompanying National Transformation Program⁴ (NTP), on behalf of King Salman bin Abdulaziz Al Saud.

The long-term proposals and the defined near-term project goals laid out by the Crown Prince seek to provide greater financial stability for Saudi Arabia and unlock opportunities for citizens and the Kingdom to realise great ambitions on the world stage. Vision 2030 aims to diversify income and invest strategically in domestic infrastructure, as well as high quality international assets, whilst tending towards a more secular future.

The Modern Kingdom of Saudi Arabia

Since embarking on the search for crude oil, Saudi Arabia has flourished as an energy producer and exporter. The main engine has been the national petroleum and natural gas company, Saudi Aramco, which saw its first tranche of equity (1.5% free float) listed on the Tadawul exchange after its IPO on 11th December 2019. It immediately became the most valuable quoted company at the time (recorded at \$1.7 trillion). Saudi Arabia has been instrumental in the foundation and co-operation of OPEC cartel, the only intergovernmental organisation of its nature that presides over nearly 80% of global proven crude oil reserves, which has operated as a force of market authority and international diplomacy.

The Vision

Saudi Arabia's approach to future development through 'Vision 2030' is dynamic and three-pronged, addressing reform on the social, diplomatic and economic level. The greater embrace of social liberalism and the Kingdom's ambitions as a leisure tourism destination have been exemplified by Neom, a concept megacity which showcases Saudi Arabia's progressive social outlook and the Kingdom's smart city capabilities.

4 Kingdom of Saudi Arabia, 2017. Vision 2030.



Figure 8 Kingdom of Saudi Arabia

The Ancient Arabian peninsula was a centre of bustling trade activity, owing to its opportunistic location between the Nile River Valley and Mesopotamia, serving as a crossroad for travelling merchants bearing goods from the surrounding oases. The established trade routes served as arteries, connecting the Silk Road to North Africa. This activity became less prevalent over time however, as climate patterns deteriorated the local ecosystem and led to the displacement of human settlements.

Following a three-decade period of unification between 1902 and 1932, where the House of Al-Saud bound a region of sheikhdoms, kingdoms and other political and dynastic territories fractured by tribal and sectarian differences, the modern Kingdom of Saudi Arabia (the 'Third Saudi State') was established by royal decree.

Vision 2030

Saudi is targeting **3** cities to be recognised amongst the top-ranked 100 cities in the world in 2016

Recognising the volatility of the crude oil markets, sensitivity to geopolitics and the headwinds ahead for the traditional energy sector, Saudi Arabia has sought to develop non-oil economic activity and diversify investment exposure through a long-term orientated sovereign wealth fund, the Public Investment Fund of Saudi Arabia (PIF).

The purpose of the PIF is to fund domestic ‘giga-projects’, real estate and infrastructure development, as well as to unlock value in domestic companies and incubate competitive national champions, positioning Saudi Arabia in a diversified pool of high quality strategic international investments. The Kingdom’s revenue transfer model has been remodelled such that proceeds from Saudi Aramco and the oil and gas rents (historically transferred directly to the state), will be circulated to the PIF, the investment revenues of which will then be received by the state.

Saudi PIF continues to build portfolio of strategic North American opportunities in 2020

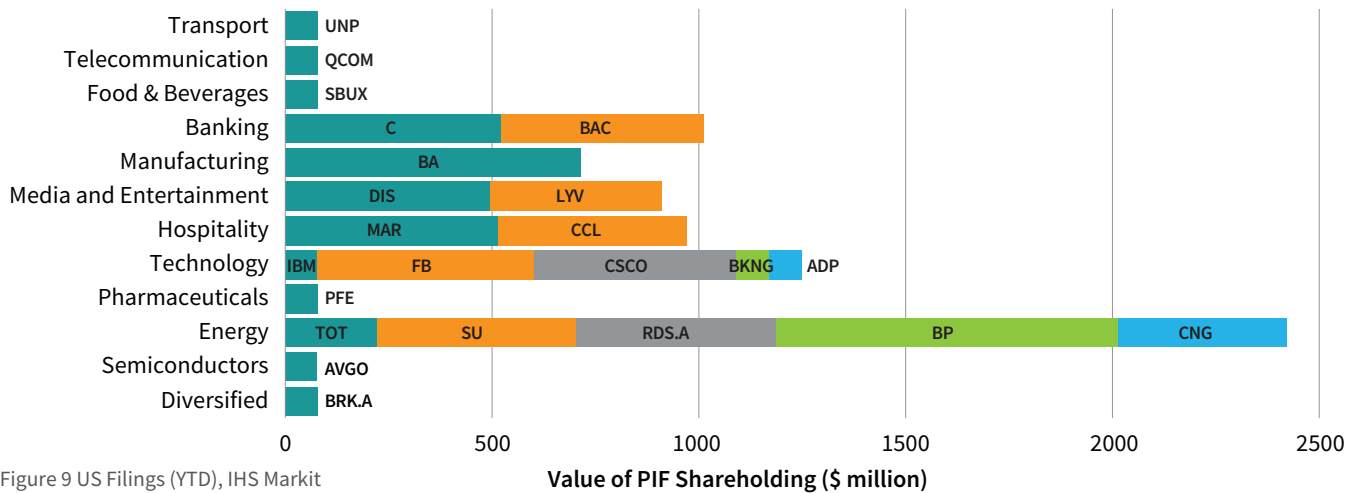
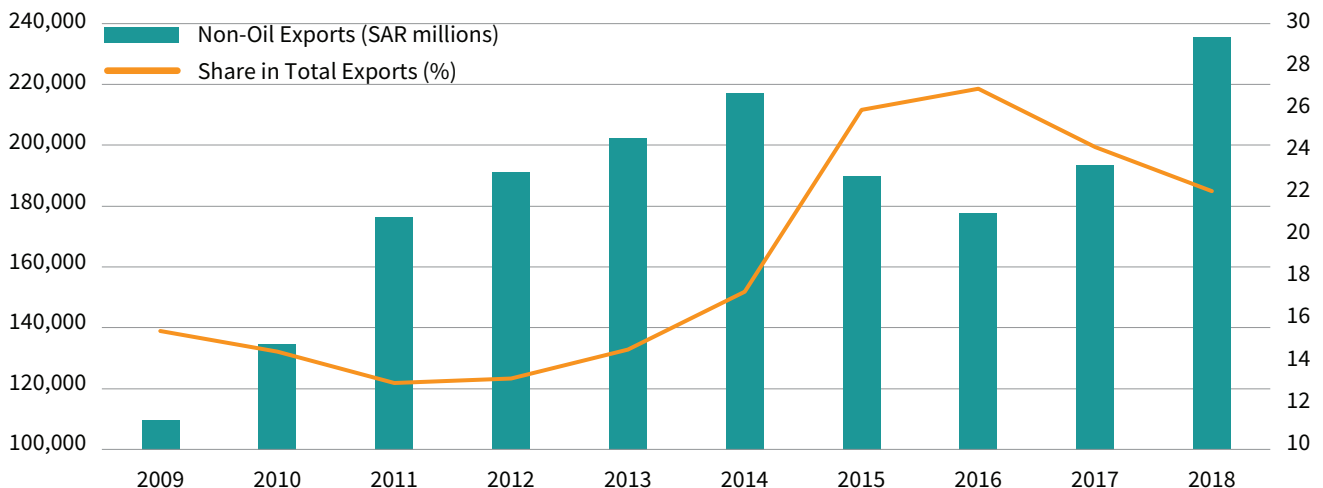


Figure 9 US Filings (YTD), IHS Markit

Saudi Arabia’s focus is also on moving higher up the hydrocarbon value chain, extracting their vast natural gas reserves and drawing further on rich natural capital, developing a competitive mining industry. This is a diversification effort that should provide a greater oil countercyclical buffer, a more consistent sovereign income stream, less concentrated economic risk and otherwise alleviate some of the symptoms of the ‘Dutch Disease’⁵ resource curse.

Diversifying the trade mix will be central to less economic cyclicality and greater income consistency



Source: Saudi Arabia General Authority for Statistics (GaStat)

5 Looney, R.E., 1988. Oil revenues and viable development: impact of the Dutch disease on Saudi Arabian diversification efforts. American Arab Affairs, pp.25-35.

This vision will be reinforced by the Kingdom’s constructive demographic profile. Almost 60% of the country’s population is under 30 years of age. There is a focus on priming this youthful workforce and ‘enriching human capital’ through education. Currently, the Kingdom’s literacy rates are amongst the highest in the Middle East, and is a great importer of international education, through its strong international education programs for nationals, and the attraction of global education franchises into the Kingdom.

Terra Firma

Saudi Arabia, over the years, has strengthened its balance sheet and built strategic oil reserves (268 billion barrels (Gbb)) as an economic buffer. The Central Bank has committed to purchasing significant foreign currency reserves (although the domestic reserve account has contracted due to recent overseas investments by the PIF) as the Riyal remains pegged to the United States Dollar (at a rate of about 3.75 Riyal to one US Dollar), providing greater FX stability in tumultuous markets. Greater market governance has been at the forefront of the Kingdom’s efforts to bolster investor confidence locally and abroad.

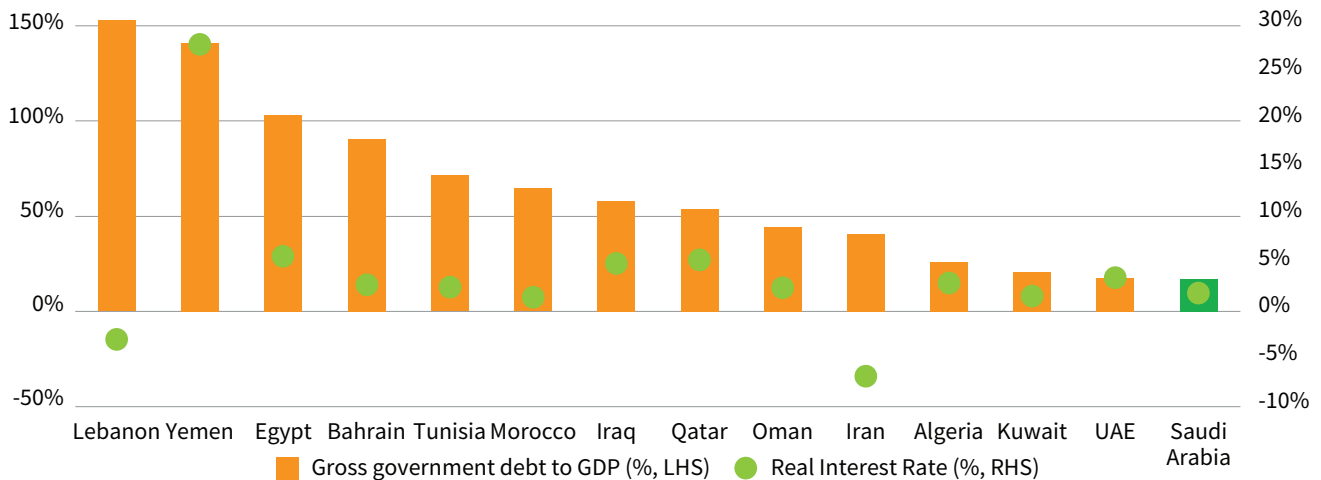
The government debt market activity is benign, the government’s historical demonstration of fiscal prudence in the public debt markets allows for headroom to raise cheap growth capital.

Vision 2030

The Kingdom is targeting an increase of SAR 1 trillion in total non-oil government revenue, from 163 billion riyal (\$43 billion)

“Almost 60% of the country’s population is under 30 years of age”

Government debt to GDP levels are the most reserved amongst the region

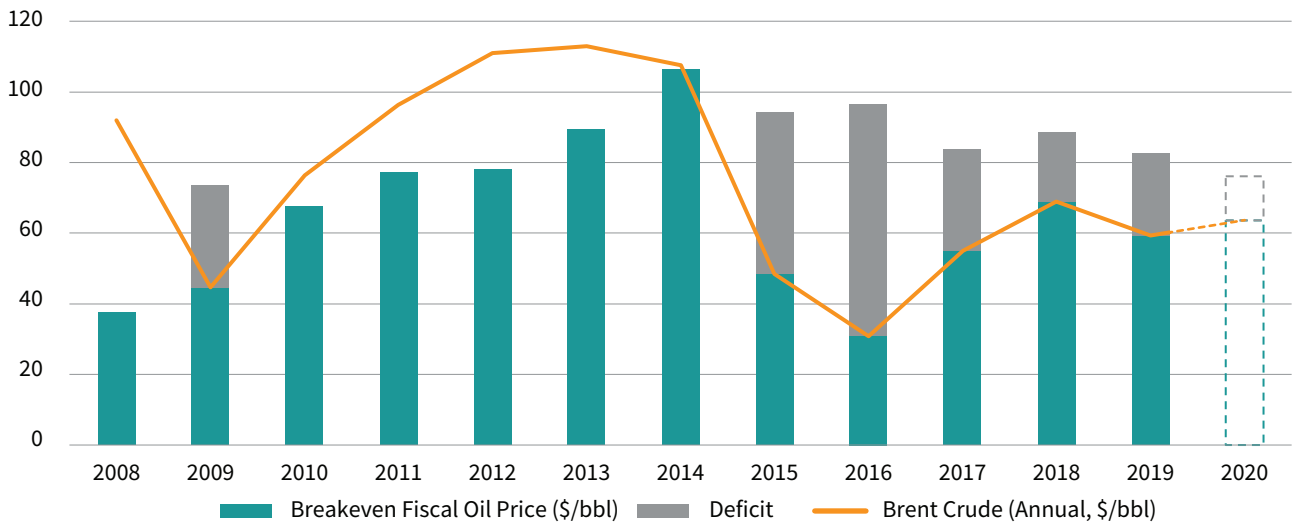


Source: International Monetary Fund, Regional Central Banks, IHS Markit

The last half-decade has brought with it lower oil prices than the prior, contributing to a fiscal deficit. Saudi’s oil production strategy has displayed a recommitment to addressing the deficit. Saudi Arabia is already positioned near the bottom-end of the Crude cost-curve, allowing the Kingdom to weather soft market dynamics, and driving down the fiscal breakeven will provide the Kingdom with a capacity to respond to future fiscal emergencies, greater leverage in political exchanges and flexibility in long-term oil supply strategy.



Saudi Arabia is renewing their focus on reducing the fiscal breakeven, and adjusting production strategy to offset the deficit



Source: International Monetary Fund (projections), U.S. Energy Information Administration, IHS Markit

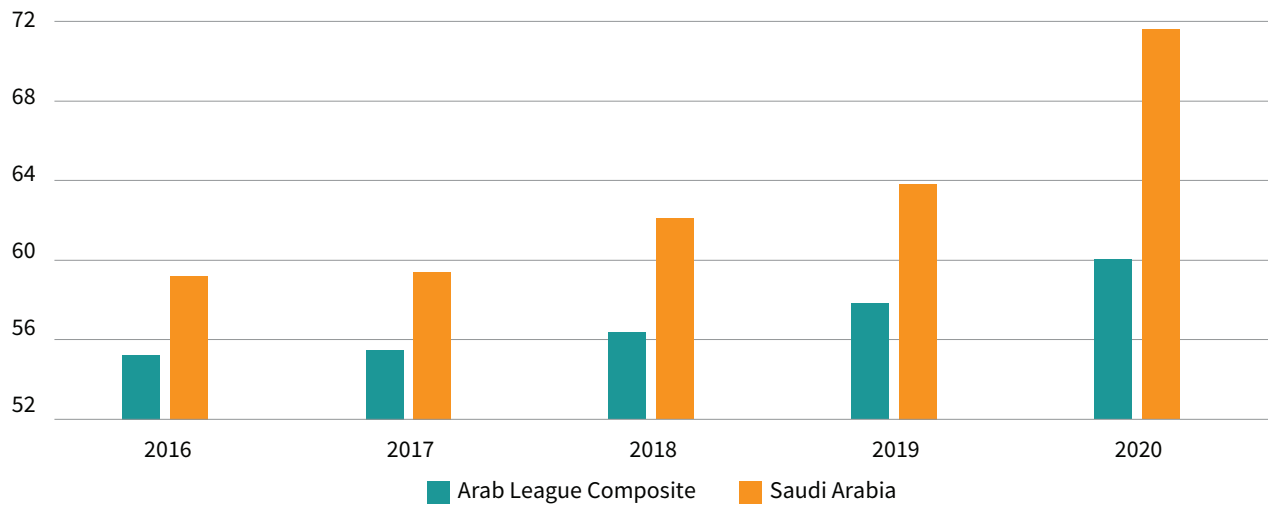
The rate of reform of the entrepreneurial environment in the MENA region is rapid, and Saudi is leading fellow members of the Arab League. Attracting and retaining ‘ambitious’ companies and employees is central to Saudi’s blueprint, and creating an auspicious environment, conducive of commercial growth, is at the forefront of this strategy.

“We try to work only with the dreamers. This place is not for conventional people or companies.”

**Crown Prince
Mohammed bin Salman**



Ease of Doing Business Score



Source: Ease of Doing Business rankings, The World Bank

The developments have been driven by the loosening of bureaucracy, the reinforcement of civic infrastructure and the improvement of administrative processing efficiency. This was a focus of development that began last decade, prompted by top-down pressure from King Abdullah. The explicit mission to reduce the resistance to start a business and improve EoDB ranking was coined the '10-by-10 initiative' (achieve a Doing Business overall rank of below 10 by 2010) was launched. The Saudi Arabian General Investment Authority (SAGIA) created the National Competitiveness Center (NCC) in the Summer of 2006 to monitor, assess and support the simplification of the business entry process, and the streamlining of administrative workflow⁶. The Kingdom continues to reap the benefits of the initiative.

⁶ Al-Awwad, D., 2007. Eliminating minimum capital requirement and facilitating business start-up in Saudi Arabia.

Saudi Arabia is now focusing on facilitating business activity

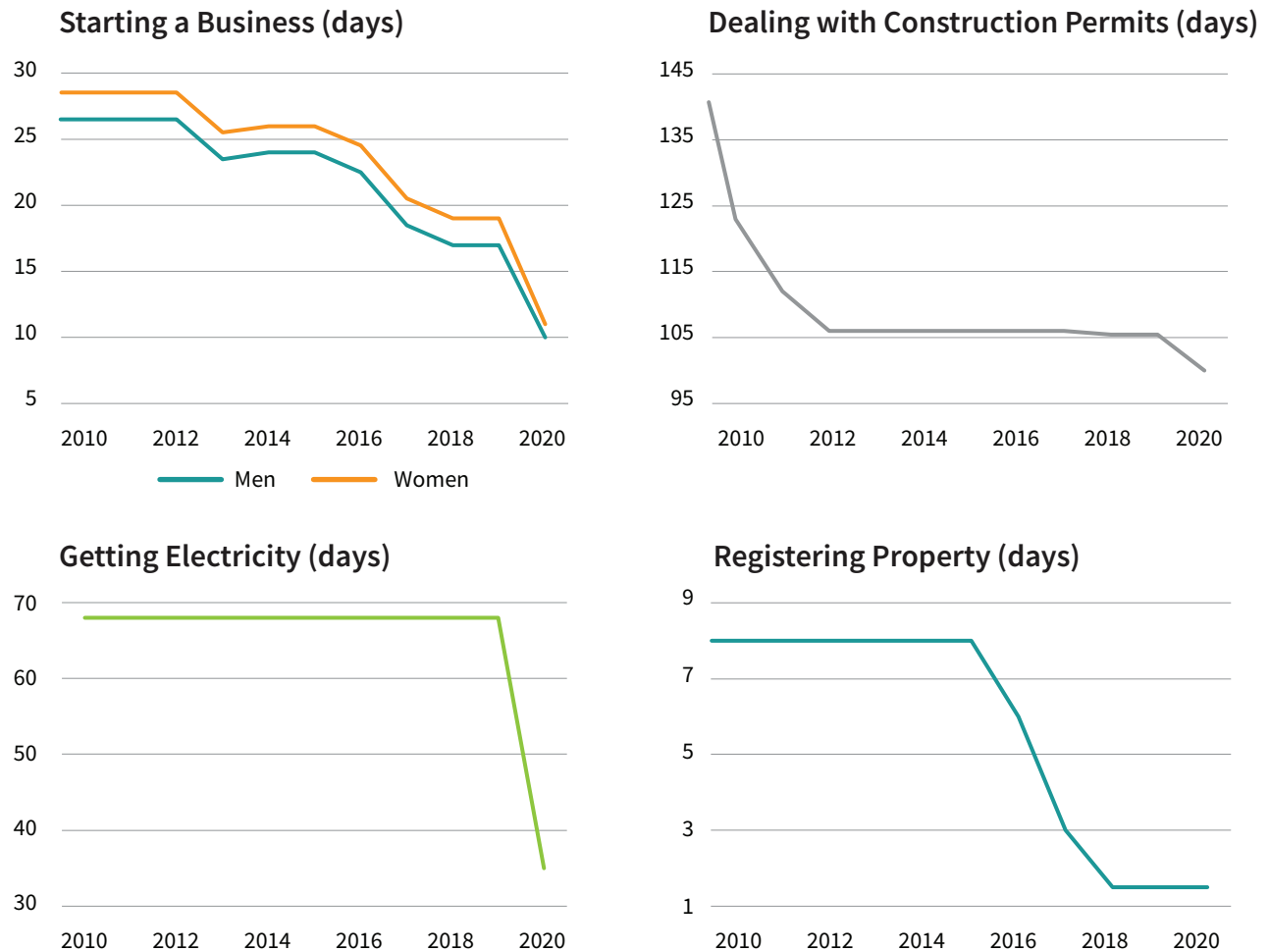


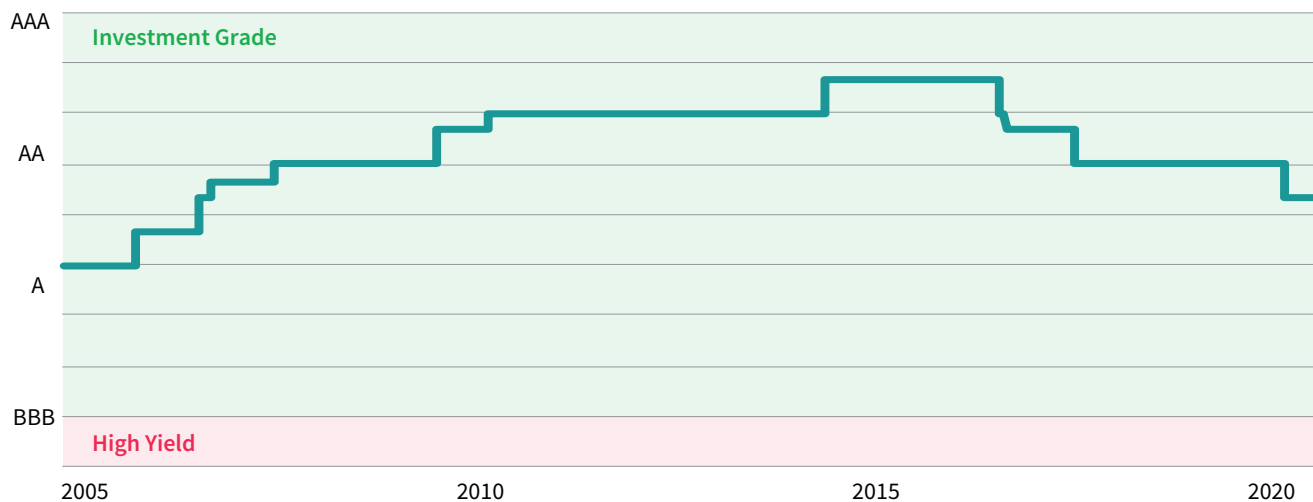
Figure 10 Ease of Doing Business rankings (composite metrics), The World Bank

Saudi Arabia's process of economic consolidation, stabilisation and liberalisation have been captured in its credit rating and outlook. The 21st century has brought with it incremental improvements in domestic conditions, although recent developments have been unconstructive.

Vision 2030

7% Goal unemployment rate of Saudi nationals, from 12%

Saudi Arabia Sovereign Credit Rating



Source: IHS Markit (iBoxx Average Rating)

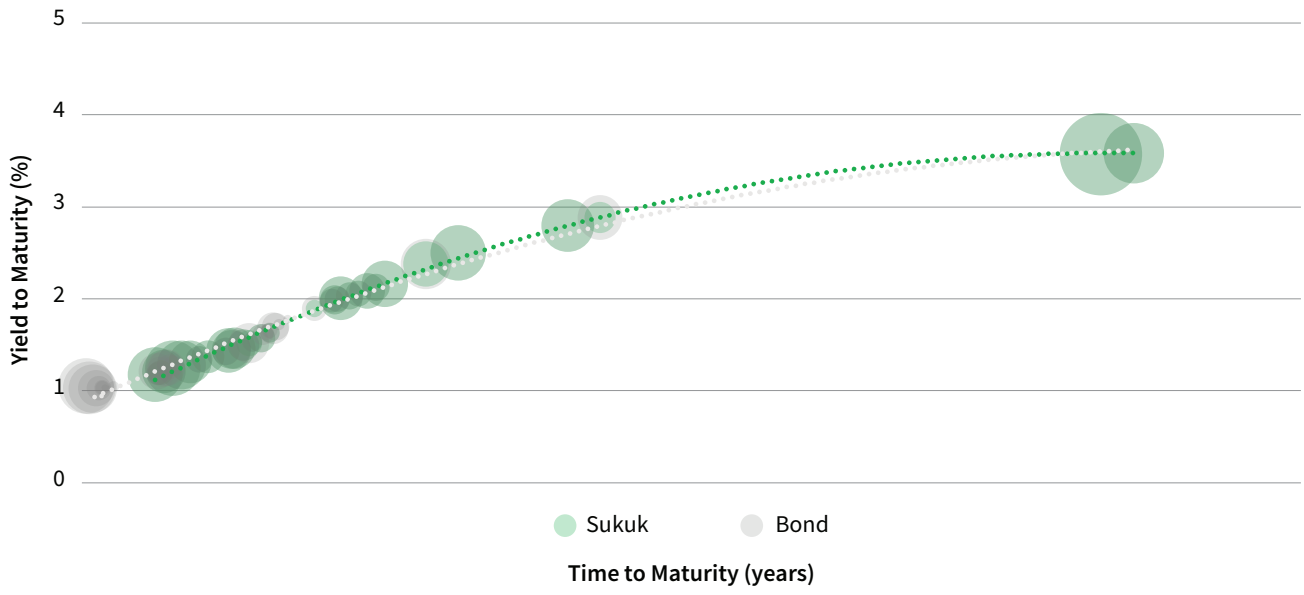
To facilitate Saudi Arabia's ambitious Vision 2030, Saudi will be able to make use of its capacity to borrow long-term from the capital markets to support the targeted scale of economic growth.

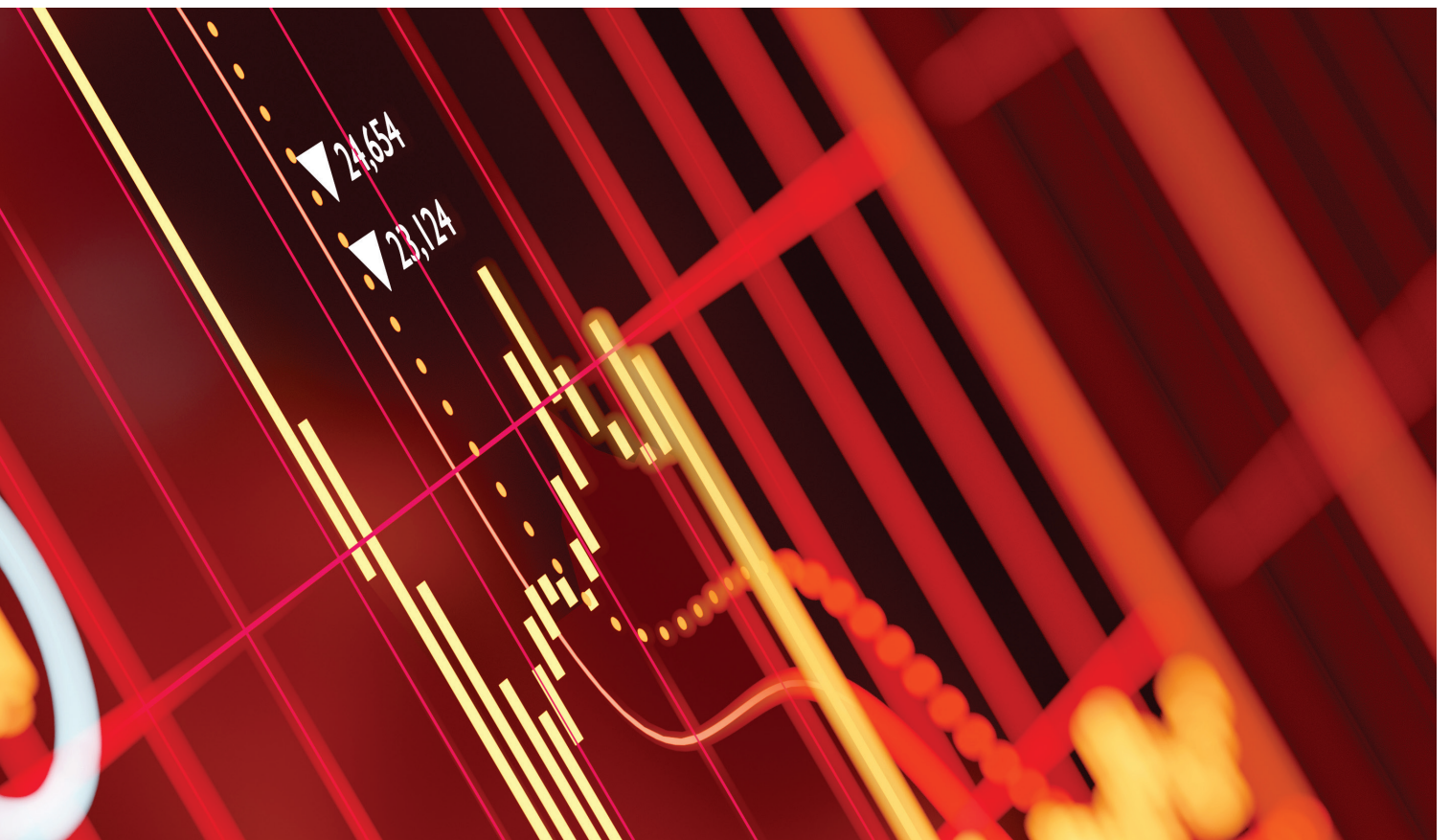
The iBoxx Tadawul SAR Government Sukuk Index is the first of its kind to provide investors with passive, transparent, rules-based exposure to this unique social and economic story and the flourishing Sharia-compliant government issuance environment in one of the strongest fiscal profiles in the Middle East and North Africa region.

In addition, the offering has been broadened, introducing the iBoxx Tadawul SAR Government Sukuk and Bond Index, which provides additional exposure to conventional locally denominated sovereign bonds issued by the Kingdom of Saudi Arabia.

For investors agnostic towards the Sharia-compliance of underlying bonds, the iBoxx Tadawul SAR Government Sukuk and Bond Index provides an additional 22 securities, an accretion of SAR 81 billion on market value. This is an expansion of about 34% compared to the Sukuk universe's underlying market value.

A key innovation of both indices is the provision of dynamic daily pricing. Through IHS Markit's proprietary pricing methodology, the primary source of data (live trading activity originated by brokers and fed through the Tadawul exchange) allows pricing for non-traded bonds to be implied from the adaptive yield curve, constructed on securities with daily price availability, where bond prices and dependent analytics would typically be stale if there is no underlying trading activity.





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