الراجحي المالية
Al Rajhi Capital

Research Department
ARC Research Team
Tel +966 11 211 9370, research@alrajhi-capital.com

Key theme

We discuss the impact of reversal of cut in allowances that was announced last night. We believe the domestic consumption stocks such as retail and food are likely to be the most benefited from this move.

Saudi Arabian Economy

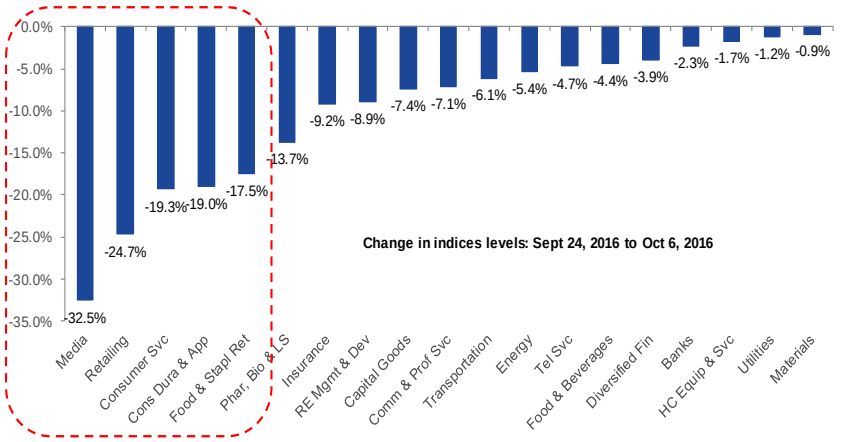
Allowances reinstated

The Kingdom restored civil service and military allowances that were previously cut in September last year following a string of austerity measures. We believe the allowances and bonus were reinstated after an official review that saw better than expected budgetary performance in Q1 2017. As per our calculations, the government's revenue target for 2017 accounts for oil price at USD50.3/barrel while average oil prices for Q1 2017 have been higher at USD52/barrel and on the other hand costs have been rationalized by SAR17bn in Q1 2017 (source: MOF). The allowance cut was previously announced when Brent was trading below USD45/barrel but there is confidence that oil prices now are likely to remain steady at around USD50/barrel or improve from hereon. The decision to reverse allowance cut is likely to boost overall consumption in the economy, as higher disposable income will benefit core consumption sectors i.e. retail and food sectors. Notably these were the sectors which saw the steepest fall post announcement of allowance cut in September 2016. Other sectors such as Banks, especially the ones exposed to retail segment are also likely to benefit. The reversal of allowance cut also highlights improved confidence in the economy, which is positive for the broader market in general.

Reducing deficit: A royal decree was issued on 22nd April 2017 which restored allowances and bonus for civil servants and military personnel that have been earlier cut in September 2016. The enabling factors seem to be lower than expected deficit (by 50%) in Q1 2017 due to increase in Govt. revenue and reduction of expenses due to rationalization of government expenditure. Note that the kingdom ordered ministries and agencies to review unfinished infrastructure and other projects which led to SAR 17bn of savings. Further, the Central Bank now expects the trade deficit to possibly move into a surplus in 2017.

Improving confidence in the economy: The reversal of allowance cut is positive for the economy as it points to higher confidence that the Govt will be able to meet/better the fiscal targets as mentioned in Fiscal Balance program.

Figure 1 Consumer driven sectors were the most impacted in the week after cut in allowances

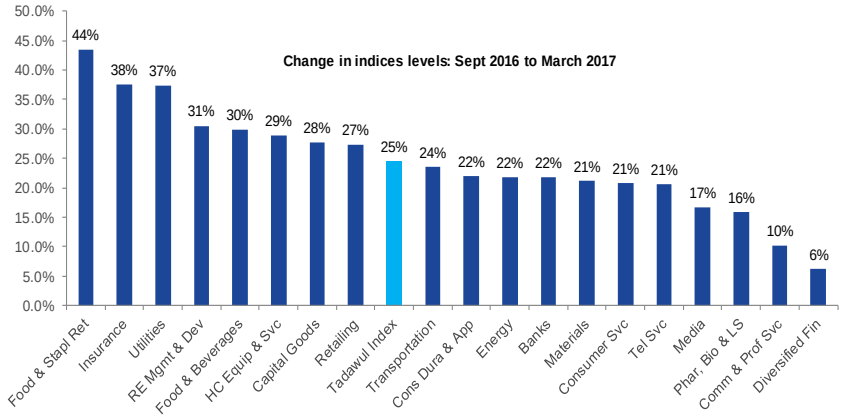


Source: Tadawul, Al Rajhi Capital

Notably, the total allowances constituted SAR80bn or around 25% of total public salaries and allowances in 2015 while the savings in expenditure has already been 1/4th of the total allowances.

Impact on stocks: The decision is broadly positive for equities and is likely to boost consumption driven sectors such as retail, food etc. Retail, Consumer services, consumer durables, food and staple sectors had seen the steepest fall in the week post the decision to cut allowances (Sept 2016), refer figure 1. We believe these are the stocks that are likely to benefit from announcement. Even stocks in other sectors such as Banking, Construction etc. could see a boost due to higher overall confidence in Govt spending while export oriented sectors could also witness an uplift on increased likelihood of progressive subsidy cuts on feedstock being deferred.

Figure 2 Non-discretionary consumer sectors (esp. Food) outperformed the Tadawul while discretionary consumption underperformed



Source: Tadawul, Al Rajhi Capital

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Contact us

Mazen AlSudairi
Head of Research
Tel : +966 1 211 9449
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

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