



MENA WATCH

Saudi households to be a weak spot in 2018

- ***Fiscal policy set to be loosened this year, but households are likely to miss out.***
- ***While households will benefit from a new allowance and recent bonuses...***
- ***...this will only just offset the impact of inflation-raising austerity measures.***

The Saudi government looks set to loosen fiscal policy this year which should support a pick-up in economic growth. However, as we explain in this *Watch*, households won't be net beneficiaries from this. The introduction of a new household allowance and recent bonus awards will only just offset the impact of a wave of austerity measures that will cause inflation to jump to as much as 6.5% this year. Overall, we expect household spending to remain a weak spot in the broader economic recovery.

Government doles out bonuses to stymy discontent

The Saudi 2018 budget announced towards the end of last year outlined a looser fiscal stance than we had envisaged. **The authorities loosened the purse strings further this month after they announced a wave of bonuses for public sector workers.** All civil service employees and members of the armed forces will now receive a "Cost of Living Allowance" of SAR1,000 (\$267) per month for one year. In addition, military personnel operating in Yemen will receive a one-off bonus of SAR5,000 (\$1,333), while retirees and those on social security benefits will receive an additional SAR500 monthly stipend.

The bonus award appeared to be a direct response to a backlash by households following the imposition of a wave of austerity measures at the start of this year. In a long-awaited move, the government introduced a new value-added tax (VAT), a key component of its efforts to generate greater sources of non-oil revenues. The tax has been introduced at an initial rate of 5% which, by our estimates, will apply to roughly 50% of goods and services in the CPI basket. Other goods and services will either be exempt from VAT or be zero-rated.

On that basis, VAT will directly boost headline inflation by around 2.5%-pts. Of course, given the weakness of domestic demand over the past couple of years, firms may decide to some absorb some of the rise in prices from VAT in their profit margins, moderating the impact on inflation.

The government also implemented a raft of administered price hikes at the start of this year. **Perhaps most prominent among these was a revision to electricity tariffs, which will go up more aggressively compared with the previous round of revisions in 2016.** As Table 1 shows, tariffs for low-end consumption have risen by as much as 260%. It is difficult to gauge precisely how this will impact the inflation figures but our estimates point to the average electricity bill rising by close to 100%. Electricity accounts for 2.3% of the CPI basket so the tariff hikes will directly add 2.3%-pts to headline inflation.

Table 1: Electricity Tariff

Old Tariff		New Tariff		Change
Monthly Usage (kwh)	SAR	Monthly Usage (kwh)	SAR	
1 to 2000	0.05			260%
2001 to 4000	0.10	1 to 6000	0.18	80%
4001 to 6000	0.20			-10%
> 6000	0.30	> 6000	0.30	0%

Source: Electricity & Cogeneration Authority, Capital Economics

The government has also initiated a series of fuel price hikes. (See Table 2 over the page.) Gasoline prices have risen by as much as 127% as the government continues with its efforts to raise fuel prices closer to international benchmarks. In fact, gasoline prices in the Kingdom are closing in on those in the US and therefore seem to be much closer to market levels. The upshot is that further price hikes are likely to be less aggressive.



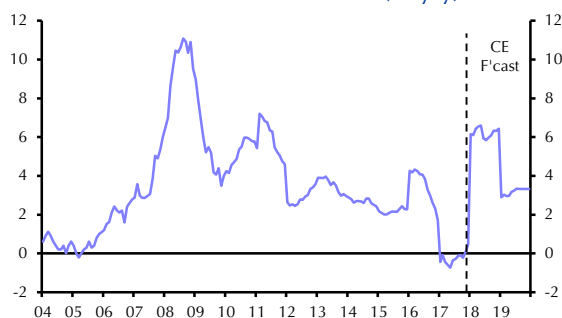
Table 2: Fuel Prices

	Old Price SAR/litre	New Price ¹ SAR/Litre	Change
Gasoline (91 Octane)	0.75	1.37	83%
Gasoline (95 Octane)	0.90	2.04	127%
Diesel (Industry)	0.38	0.38	0%
Diesel (Transport)	0.38	0.47	0%

Sources: Saudi Press Agency. ¹Includes value-added tax.

Altogether, we estimate that the introduction of VAT and the administered price hikes will cause inflation to jump to around 6.5% y/y over the coming months. (See Chart 1.) For the year as a whole, we expect inflation to average 6.2%, which is significantly above consensus expectations for inflation of 3.4% and the government's own forecast of 5.7%.

Chart 1: Consumer Prices (% y/y)



Sources: CEIC, Capital Economics

At the same time, expatriate households will have to contend with an increase and broadening of the expat levy. The levy now covers expat workers who will face a monthly fee of up to SAR400 in order to work in the Kingdom. The monthly fee for dependents has doubled from SAR100 to SAR200.

Fiscal measures broadly offsetting

The response to the backlash suggests that the authorities are keen to shore up support for Crown Prince Mohammed bin Salman ahead of a possible abdication by his father. Policymakers may also be fearful of spillovers from the unrest in Iran and more recently Tunisia, which has been largely centred on economic issues. And the recent jump in oil prices no doubt reassured the authorities that they could afford to react to signs of public discontent.

In aggregate, though, the transfers that will raise households' income will only just offset the measures that will push up inflation and erode the *real* value of those incomes. Both the tightening and loosening measures affecting households are equivalent to around 3% of GDP, or 4.5% of non-oil GDP. (See Table 3.)

Table 3: Fiscal Measures Affecting Households

	% of GDP	% of Non-oil GDP
Tightening Measures		
Expat Levy	1.0	1.4
Value-added Tax	0.9	1.3
Fuel Price Hike	0.7	1.1
Electricity Tariff Hike	0.5	0.8
Total	3.1	4.6
Loosening Measures		
Citizen's Account	1.2	1.8
Cost of Living Bonus	1.9	2.8
Total	3.1	4.6

Source: Ministry of Finance, Capital Economics

Summary

In short, then, while the government is loosening fiscal policy this year, the overall impact of households is likely to be neutral. As a result, we expect household spending to remain sluggish in 2018 and a weak spot in the broader economic recovery.

That said, it's worth pointing out that the fiscal measures are likely to have varying effects on households. For example, households of Saudi nationals – particularly those working in the public sector – are likely to see a net gain. In contrast, expatriate households look set to be main losers.



Latest Data & Main Forecasts

Main Economic Forecasts

	Share of World	GDP				Inflation			
		2016	2017	2018	2019	2016	2017	2018	2019
Saudi Arabia	1.5	1.7	-0.7	1.5	1.0	3.5	-0.3	6.3	3.0
Egypt	0.9	3.8	4.0	4.5	5.0	13.8	29.6	15.0	10.0
UAE	0.6	3.0	2.0	3.0	3.0	1.6	2.3	3.3	2.5
Algeria	0.5	3.5	1.8	1.3	1.5	6.4	5.0	6.0	7.5
Qatar	0.3	2.2	0.8	1.8	2.0	2.8	0.5	2.0	2.0
Kuwait	0.3	3.5	0.0	1.5	1.5	3.2	2.0	2.3	3.5
Morocco	0.2	1.2	4.0	3.0	4.5	1.6	0.7	2.3	3.0
Oman	0.2	2.0	0.5	1.0	1.0	1.1	1.5	3.0	2.8
Tunisia	0.1	1.1	2.0	3.0	3.5	3.7	5.0	5.3	4.8
Lebanon	0.1	2.1	2.3	2.5	2.8	-0.8	2.8	3.3	3.3
Jordan	0.1	1.0	1.3	1.5	1.8	-0.8	3.3	1.5	1.5
Bahrain	0.1	3.0	2.5	2.0	2.0	2.7	1.5	3.5	3.0
MENA	4.7	2.6	1.5	2.5	2.5	5.3	7.3	6.8	4.8

Sources: CEIC, Thomson Reuters, Capital Economics

Latest Market Data

	Equities		CDS Premia		Bond Yield	
	1 mth ago	Latest	1 mth ago	Latest	1 mth ago	Latest
Abu Dhabi (UAE)	4,337	4,339	66.5	57.4	3.34	3.33
Algeria	-	-	-	-	-	-
Bahrain	1,265	1,266	292.2	288.2	6.54	6.45
Dubai (UAE)	3,468	3,355	140.4	119.3	3.04	3.07
Egypt	14,025	14,680	351.2	333.1	6.38	6.34
Jordan	2,091	2,147	349.8	349.8	6.37	6.31
Kuwait	6,286	6,332	-	-	3.32	3.35
Lebanon	1,118	1,136	573.0	573.0	7.38	6.83
Morocco	10,361	10,114	127.2	123.4	3.13	3.54
Oman	5,111	5,062	-	-	5.16	5.38
Qatar	7,761	8,212	103.5	93.9	3.62	3.65
Saudi Arabia	6,912	7,076	93.1	86.2	3.52	3.53
Tunisia	6,159	6,149	-	-	5.97	5.87

Sources: Bloomberg, Thomson Reuters



Monthly Diary

The Month Ahead

	Country	Release / indicator / event	Time (GMT)	Previous	Median	CE Forecast
January						
Sun 28 th		Sau International Reserves (Dec)	-	\$494.4bn	-	-
February						
Mon 5 th		Egy Whole Economy PMI (Jan)	04.15	48.3	-	-
		Sau Whole Economy PMI (Jan)	04.15	57.3	-	-
		UAE Whole Economy PMI (Jan)	04.15	57.7	-	-
		Leb Whole Economy PMI (Jan)	09.00	46.1	-	-
Thu 8 th		Egy Urban CPI (Dec)	-	-0.2%(+21.9%)	-	+2.2%(+19.7%)
		Egy Core CPI (Dec)	-	(+19.9%)	-	-
Expected during this period:						
9 th – 11 th Jan		Jor CPI (Dec)	-	+0.2%(+3.3%)	-	+0.2%(+3.2%)
10 th – 20 th Jan		Oma CPI (Dec)	-	-0.2%(+1.3%)	-	+0.3%(+1.6%)
10 th – 20 th Jan		Qat CPI (Dec)	-	+0.1%(+0.2%)	-	-0.3%(+0.7%)
10 th – 13 th Jan		Jor Industrial Production (Nov)	-	(+0.2%)	-	-
14 th – 21 st Jan		Mor CPI (Dec)	-	+0.4%(+1.3%)	-	0.0%(+1.4%)
15 th – 25 th Jan		Sau CPI (Dec)	-	+0.1%(+0.1%)	-	-0.2%(+0.4%)
15 th – 20 th Jan		Egy Trade Balance (Dec)	-	-\$3.2bn	-	-
18 th – 22 nd Jan		UAE CPI (Dec)	-	0.0%(+1.7%)	-	+0.2%(+1.8%)
19 th – 25 th Jan		Bah CPI (Dec)	-	-0.2%(+2.9%)	-	-0.5%(+1.7%)
20 th – 30 th Jan		Kuw CPI (Dec)	-	0.0%(+1.5%)	-	+0.9%(+1.4%)
20 th – 5 th Jan		Sau Non-oil Trade (Nov)	-	(+13.1%)	-	-
21 st – 22 nd Jan		Leb CPI (Dec)	-	+0.6%(+4.8%)	-	-0.7%(+3.7%)

Expected during this period:

3rd – 8th Feb  **Egy** Foreign Exchange Reserves (Jan)

- \$37.0bn - -

*m/m (y/y) unless otherwise stated; p = provisional estimate

Source: Bloomberg, Thomson Reuters, Capital Economics



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