Prince Mohammed says the Saudi SWF will include current fiscal assets of about US$600 billion, plus US$1 trillion from the sales of state-owned real estate and industrial areas and Aramco shares. PHOTO: REUTERS

Saudi Arabia to create world's largest wealth fund

It unveils a vast plan to transform its oil-dependent economy and will sell shares in state energy giant Aramco

Riyadh

SAUDI Arabia said on Monday that it would create the world's largest wealth fund and sell shares in state energy giant Aramco as it unveiled a vast plan to transform its oil-dependent economy.

The announcement of the long-term reform programme, dubbed "Saudi Vision 2030", marks the beginning of a hugely ambitious attempt to move Saudi Arabia beyond oil, the backbone of its economy for decades, amid a steep fall in prices.

The key architect of the diversification plan, deputy crown prince Mohammed bin Salman, said that if it works Saudi Arabia "can live without oil by 2020".

In an interview with the Saudi-owned Al-Arabiya news channel after the government approved the programme, the 30-year-old prince outlined a series of measures aimed at reshaping his desert kingdom's economy.

"We have all developed an oil addiction in Saudi Arabia and this is dangerous and has hampered development in many sectors during past years," he said.

Prince Mohammed said part of the plan is "to sell less than 5 per cent of Aramco" in an initial public offering (IPO), valuing the company at between US$2 trillion and US$2.5 trillion. By "selling even one per cent of Aramco, it will be the largest IPO in the world", he said.

Part of the funds from the share sale, he said, will be used to set up a US$2-trillion sovereign wealth fund (SWF), which would easily surpass Norway's US$865-billion fund as the world's biggest.

SWFs are used commonly as investment arms for oil-dependent nations seeking to diversify revenue streams, and are among the world's largest institutional investors.

With so much capital on its hands, the Saudi SWF would make Riyadh one of the single most important global investors.

It will be "by far the largest on the planet", Prince Mohammed said. "There will not be any investment or development in any region of the world without the Saudi sovereign wealth fund having a say." The fund will include current Saudi fiscal assets of around US$600 billion, as well as returns from the sales of Aramco shares and state-owned real estate and industrial areas estimated to be worth US$1 trillion, he said.

The reform programme was approved by the government during a special cabinet meeting chaired by his father King Salman, who urged Saudis to support the "ambitious plan", the official SPA news agency reported.

It is also to include major structural reforms, privatisations and efforts to increase government efficiency, the prince said.

For decades Saudi Arabia, the world's biggest crude exporter and the largest economy in the Arab world, has enjoyed a huge windfall from its massive and easily exploitable oil reserves.

Flush with oil revenues, the nation has built up enormous fiscal reserves and provided its 28 million citizens with a generous system of public employment, welfare benefits and subsidised utilities.

But analysts have long warned that the Saudi system, which counts on oil for 70 per cent of state revenues, is deeply bureaucratic and inefficient, leaving the economy vulnerable.

And the recent dramatic fall in oil prices – from more than US$100 a barrel in early 2014 to around US$40 a barrel this month – has underscored the dangers.

Riyadh posted a record budget deficit in 2015. With another US$87-billion shortfall projected for this year, the government took the unprecedented step of raising retail fuel prices by up to 80 per cent in December and cutting subsidies for electricity, water and other services.

Cracks have begun to appear in the tightly controlled kingdom, with increasing criticism on social media from Saudis concerned over the hit on their wallets.

On Saturday, King Salman sacked the water and electricity minister, Abdullah al-Hussayen, who had drawn criticism for his handling of price increases, including a suggestion that citizens upset over high water bills dig their own wells.

Saudi fiscal reserves also dropped to a four-year low last year, down from US$732 billion in 2014 to US$611.9 billion.

Still, Saudi Arabia's reserves remain among the largest in the world, tempering any concerns about the economy's short-term viability.

And the fall in oil prices is largely due to Opec kingpin Saudi Arabia's own refusal to cut production as it seeks to drive less competitive players out of the market, in particular US shale producers. AFP

China expected to see US$538b capital exodus in '16

London

GLOBAL investors are expected to pull US$538 billion out of China's slowing economy in 2016, the Institute of International Finance estimated on Monday, although the pace of outflows has dropped.

That number would be down a fifth from the US$674 billion pulled out last year, the industry association said, but could accelerate again if fears re-emerge of a "disorderly" drop in the yuan, or renminbi.

Capital exodus from China is crucial for emerging markets more generally, partly because of its sheer size and partly because sustained outflows can trigger more exchange rate volatility, which would then feed a fresh wave of outflows.

"A sharp drop in the renminbi would likely spark a renewed sell-off of global risk assets and trigger a flight of portfolio capital from emerging markets," the IIF said in a new report. "Moreover, a sharp depreciation of the renminbi could lead to a round of competitive devaluation in other emerging markets, particularly in those with close trade linkages to China."

For now, though, outflows are slowing. Roughly US$35 billion was pulled out in March, bringing the total since the start of the year to around US$175 billion, well below the pace seen in the second half of 2015.

The IIF cited progress Chinese authorities had made in easing worries about the yuan's direction. They had emphasised that there is more focus on its value against a basket of currencies, rather than just the US dollar.

One "important unknown", however, is the threshold of currency reserves below which the Chinese authorities would start to worry. They might then either allow the yuan to fall again or markedly tighten capital controls.

Headline reserves have already fallen from US$4 trillion in June 2014 to around US$3.2 trillion in February 2016. That is still high compared with most countries.

But using another calculation developed by the IMF, the cushion between actual reserves and what could be required, has dropped to 15 per cent from 50 per cent just under two years ago.

"From this perspective, continued large capital outflows could lower the country's official reserves to a level that is regarded as inadequate without a serious tightening of capital controls," the IIF said. REUTERS

Fed's scope for summer rate hike widens as ECB signals a hold

Washington

MARIO Draghi has opened a door. Janet Yellen has to decide whether she wants to walk through.

The European Central Bank (ECB) president signalled last week that policy on his side of the Atlantic is going on hold as officials wait to see how their stimulus measures play out. That pause may hand the Federal Reserve chair an opportunity to raise interest rates in coming months, by reducing the risk of a sharp rally in the dollar if the policies of the two central banks conspicuously diverged.

"The reality for the ECB is the eurozone isn't in nearly as bad a shape as Draghi would like to make out – it pushes the currency and gives the Fed far more room to move," said Rob Carnell, chief international economist at ING Bank NV in London. "Sometime in the third quarter sounds like a reasonable bet for me, but I wouldn't rule out the second quarter."

Investors see zero probability the Federal Open Market Committee will hike at its April 26-27 meeting and only a 20 per cent chance of a move at its gathering in June, eight days before Britain holds a referendum on whether to remain in the European

Ms Yellen herself said on March 29 that "caution is especially warranted".

Union. A vote by UK citizens to depart could trigger financial-market turmoil and is a source of uncertainty that may give the Fed pause. The likelihood of a move in July is 34 per cent, according to prices in federal funds futures contracts.

US policymakers expect to raise rates twice this year, according to projections they updated in March. A gradual recovery in the euro area that supports an appreciation in the single currency will strengthen their case, though the US economy still faces obstacles.

At the start of the year, the US dollar reached the highest level since 2002 in trade-weighted terms, but has eased back from that peak and the US currency has also lost ground against the euro. A stronger dollar has been a factor in holding down too-low inflation through cheaper import prices as well as denting growth by hurting exports.

Stefan Schneider, international economist at Deutsche Bank in Frankfurt, said that the ECB's shift into holding mode makes it easier for the US central bank to tighten monetary policy, though he doesn't see the move coming soon.

The Fed has a bit more leeway because the dollar strength cited by Ms Yellen as an argument for caution has ebbed recently, he said. "But the economy doesn't currently give the Fed any reason to rush."

US growth appears to have slowed in the first quarter, with some economists cutting their tracking estimates to near zero, following a 1.4 per cent gain in the final three months of last year. It may take time to resolve whether this means the economy is suffering a temporary soft patch, as it did this time last year, or has stalled the recovery. Inflation is still too low, held down by lower energy prices and a stronger dollar, and has been below the Fed's preferred gauge of price pressures since 2012. Wages are also subdued, suggesting there's still slack in the labour market, despite a 5 per cent unemployment rate in March that Fed officials say is near their estimates for full employment.

On the other hand, some risks that were prominent in the policy debate earlier this year have faded. Financial conditions have eased and China's economic outlook appears to have stabilised, with the International Monetary Fund predicting that the world's second-largest economy will slow less than previously anticipated.

Investors still see only a 64 per cent chance the Fed will have raised rates once by December, though Eric Rosengren, president of the Boston Fed and one of the central bank's most dovish officials, has warned that this view was too pessimistic.

Ms Yellen herself said on March 29 that "caution is especially warranted".

For Thomas Costerg, a senior US economist at Standard Chartered Bank in New York, that means the Fed won't raise rates this month and will refrain from sending a clear signal about June. BLOOMBERG

LATEST US DATA

Sales of new homes down for a third month in March

Washington

PURCHASES of new homes in the United States unexpectedly declined in March for a third month, reflecting the weakest pace of demand in the west since July 2014.

Total sales decreased 1.5 per cent to a 511,000 annualised pace, a Commerce Department report showed on Monday. In western states, demand slumped 23.6 per cent.

Purchases rose in two regions last month, indicating uneven demand at the start of the busiest time of the year for builders and real-estate agents. While new construction has been showing limited upside, cheap borrowing costs and solid hiring will help ensure residential real estate continues to expand.

"The overall picture is still pretty good," said Tom Simons, a money-market economist at Jefferies LLC in New York. The monthly swings in the new-house segment, a very small share of the market, "make it very hard" to get a definitive read from the headline numbers, he said. "As the labour market improves, people will be more willing to take risks and invest in housing."

New-home sales, which account for less than 10 per cent of the residential market, are tabulated when contracts get signed. They are generally considered a timelier barometer of the residential market than purchases of previously owned dwellings, which are calculated when a contract closes, typically a month or two later.

February purchases were revised to 519,000 from 512,000. The monthly data are generally volatile, one reason economists prefer to look at longer-term trends.

The report said there was 90 per cent confidence the change in sales last month ranged from a 13.5 per cent drop to a 16.5 per cent increase.

There were 246,000 new houses on the market at the end of March, the most since September 2009. The supply of homes at the current sales rate rose to 5.8 months, the highest since September, from 5.6 months in the prior period.

From a year earlier, purchases increased 5.8 per cent on an unadjusted basis.

Borrowing costs are hovering close to a three-year low, helping to bring house purchases within the reach of more Americans. The average rate for a 30-year fixed mortgage was 3.59 per cent last week, down from 3.97 per cent at the start of the year, according to data from Freddie Mac. BLOOMBERG

Fire prevention pilot programmes making some progress in Indonesia

By Jeffrey Hutton
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Jakarta

ON A RECENT afternoon in April, Craig Tribolet surveys an expanse of tinder-dry scrub not far outside of the village of Sering in the province of Riau. In October last year, three walls of fires, which were almost certainly deliberately lit, merged to lay waste to what was once a communal forest perched atop a dome of peat.

Just three days after the last gasps of the rainy season, leaves pulverise under foot in 36-degree heat. Here and there dead trees break up the 11-hectare clearing. Mr Tribolet, who oversees fire protection for Asia Pacific Resources International Holdings Ltd (April), was at this spot in October. His men ran two lengths of 60 metre hoses from water trucks parked on the access road to fend off the blaze. He reckons he'll be back to this spot before too long.

"I'd bet by July they'll be back to burn," the Australian born Tribolet said of the arsonists. "They'll want a clear space for palm oil."

To improve the odds that Tribolet and his crew won't have to make more trips to villages like Sering, April is expanding a pilot programme that rewards participating villages for preventing fires. Communities deemed "fire free" during the height of the dry season, which runs four months to October, earn 100 million rupiah (S$10,233), to be used for public amenities such as a covered market or even their own fire fighting equipment.

Last year the programme reached nine villages, including Sering, which didn't win any prize money. This year, April will dip into its US$6 million fire fighting and disaster contingency fund, earmarking US$1 million to expand the effort to 20 villages. On top of the prize money itself, the company pays for fire detection equipment, and salaries. Crew leaders at each village, each decked out in a red polo shirt embossed with the company's logo, make daily visits to neighbours to coax them away from the ultra cheap but effective practice of slash and burn.

The programme has met with some success. Last year, amid the worst fire season in two decades, April lost 50 hectares in its concession area to fire. In 2014, it lost 750 hectares.

Anderson Tanoto, who is a director at April's parent company Royal Golden Eagle, says the programme reflects a recent switch in emphasis in government and business away from fire fighting to prevention.

"I was pleasantly surprised with the results," Mr Tanoto, who is the son of the RGE's founder Sukanto Tanoto, told *The Business Times*.

"This is money better spent than operating a helicopter every day for five hours a day. Prevention is now part of the language."

Mr Tanoto said he was "embarrassed" with the TV images of last year's haze crisis as he accompanied President Joko Widodo on his first official visit to Washington DC. "The industry lost. Indonesia lost from the haze."

Environmentalists say that while the effort is welcome, it's only a small step toward undoing decades of devastating practices such as draining peat land and clear cutting virgin forest. Dried peat oxidises, sending thousands of years of carbon dioxide into the atmosphere. Last year's fires swept through 2.6 million hectares last year, one million of which was peat.

And while April may have finally found religion, thanks to a new generation of managers such as the 26-year-old US- educated Tanoto, its suppliers may be less environmentally sensitive. Some 40 independently operated suppliers currently operate on about 60 per cent of April's concession area. None has had their contracts terminated for poor fire prevention practices although one supplier is currently under suspension, the company says.

Mr Tanoto argues that cutting off suppliers drives them into the arms of rival buyers who may care less about climate change. Mr Tanoto says he prefers a softer approach that allows time to change practices over the longer term.

Similar fire prevention programmes are taking root at rival plantation companies such as Asian Pulp and Paper. A broader government effort is also said to be in the works. But such grand plans overlook the painstaking work needed to build rapport with villagers who are unimpressed with outsiders telling them what to do. April says it took four months of village talks to get the pilot programme up and running. Bairo is one example of that daily slog. The 26-year-old crew leader, who uses one name, goes house to house everyday encouraging his neighbours to refrain from slash and burn practices that are now banned by the government. Last year his village of Segama won April's prize money and will put it toward fire fighting equipment.

"We work hard to build a rapport, to encourage people to change," Mr Bairo says. "It's better than banning things without a solution."