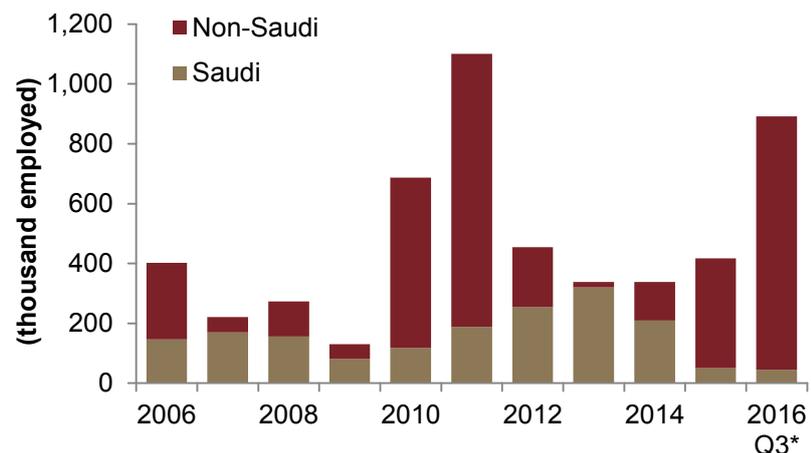




Higher labor participation and lower employment growth pushes up Saudi unemployment

- Saudi unemployment rose to a four-year high, although employment growth remained positive.
- The Saudi labor force participation rate rose to a record high, reaching 42 percent in Q3, pushed up by higher participation from both Saudi males and females.
- However, the improvement in the Saudi participation rate was associated with an irregular decline in the number of Saudis outside the labor force, which led to a significant fall in the Saudi working-age population.
- During the first three quarters of 2016, total net employment in the Kingdom saw a significant rise of 892 thousand, compared with a 417 thousand increase between 2014 and 2015.
- However, 95 percent of these positions went to non-Saudis.
- Saudi net employment reached 45.5 thousand, year-to-September, trending further down from a record low of 49.9 thousand recorded between 2015 and 2014.
- This resulted in the Saudization ratio of the whole economy falling from 43.3 percent in 2015 to 40.6 percent in Q3 2016.
- Meanwhile, the Saudi unemployment rate rose to 12.1 percent in Q3 as more Saudis joined the labor force, while employment growth slowed.
- Within the Saudi labor force, female unemployment rose faster than males, while Saudi youth unemployment rose marginally as well.

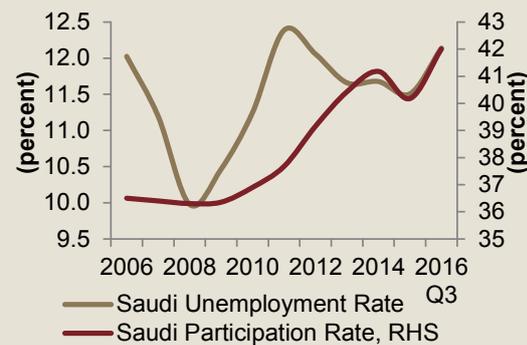
Figure 1: Breakdown of employment by nationality (year-on-year net change)



Saudi Unemployment Rate (percent)

	2015	2016 Q3
Males	5.3	5.7
Females	33.8	34.5
Youth (20-29)	27.9	28.1
Total	11.5	12.1

Key Saudi labor force indicators



For comments and queries please contact:

Fahad Alturki
Chief Economist & Head of Research
faltaruki@jadwa.com

Rakan Alsheikh
Research Associate
ralsheikh@jadwa.com

Head office:
Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

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The Saudi labor market continued to point to a high degree of segmentation so far in 2016, particularly in the employment trends between Saudis and non-Saudis. This has resulted in the Saudi unemployment rate rising despite the economy creating a near record number of jobs, year-to-September, as the majority of these jobs went to non-Saudis. The rise in Saudi female unemployment was relatively higher than males, while Saudi youth aged between 20-29 saw an increase in unemployment (See box 1). According to data recently released by the General Authority for Statistics (GAS), the overall Saudi unemployment rate rose from 11.5 percent in 2015 to 12.1 percent in Q3 2016, its highest since 2012. This rise was mainly due to an increase in Saudi labor force participation whilst during the same period, a fewer number of jobs were created for Saudis .

Improving Saudi labor force participation, but with a falling working-age population.

Year-to-September 2016 data showed a net rise in the Saudi labor force by 92.2 thousand, compared with a record low addition of 45.6 thousand in 2015. This accelerating growth in the Saudi labor force, spanned both males (rising by 49.6 thousand) and females (rising by 42.6 thousand), but was associated with an irregular net decline in the number of working-age Saudis outside the labor force, falling by 482 thousand (from 8.4 million in 2015 to 7.9 million in Q3 2016). This included a decline in both males (falling by 103 thousand) and females (falling by 379 thousand). We see this as inconsistent with the observable demographic trend in the Kingdom, and therefore believe that historical labor market statistics may be revised by GAS. The extent of this decline meant that the whole Saudi working-age population has dropped by 390 thousand (from 14 million in 2015 to 13.6 million in Q3 2016). Nevertheless, the combination of rising Saudi labor force entrants and a falling number of Saudis outside the labor force has contributed to a record high participation rate of 42 percent, with male and female participation reaching 64.6 percent and 19 percent respectively (Figures 2 and 3).

Data from 2000-2015 shows an average annual rise in working-age Saudis by 368 thousand, in line with the fertility rates (at 5.4 births per 1000) observed between 1985 to 2000. However in Q3 2016, a sudden drop by 390 thousand in the number of working-age Saudis does not correlate with the corresponding fertility rate seen 15 years ago (2001) at 3.8 births per 1000.

Year-to-September 2016 data showed a net rise in the Saudi labor force by 92.2 thousand...

...compared with a record low net increase of 45.6 thousand in 2015.

Figure 2: large improvement in participation rates (year-on-year change, 15+ years)

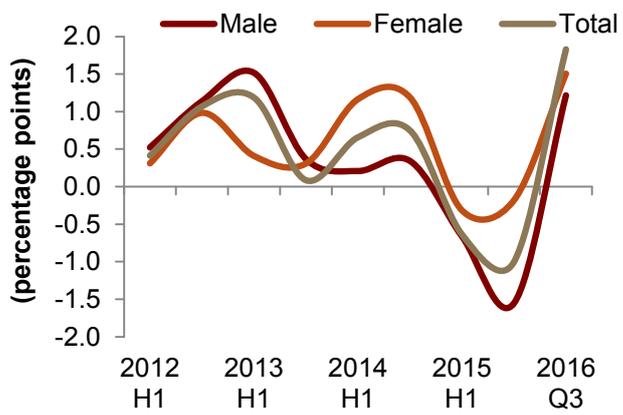
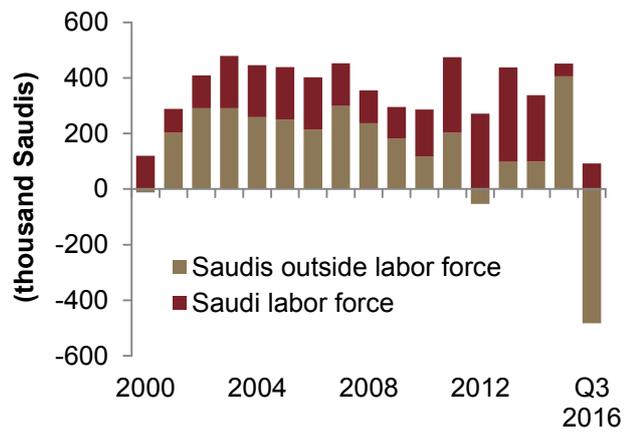


Figure 3: Irregular fall in Saudi working-age population, (year-on-year change, 15+ years)





Total net employment rose by 892 thousand...

...the second fastest pace on record.

The Saudi unemployment rate rose from 11.5 percent in 2015 to 12.1 percent in Q3 2016.

Total growth in employment is significantly higher than what fundamentals show

During the period from January to September 2016, the overall picture of the job market in Saudi Arabia pointed to a divergence from other economic indicators. Total net employment rose by 892 thousand; its second fastest pace on record. But this comes as economic growth in the Kingdom is showing signs of a slowdown in 2016 (see our November 2016 macroeconomic update), with investment likely to contract for the second consecutive year (Figure 4). That said, the majority of new jobs went to non-Saudis, while net new jobs created for Saudis reached 45.5 thousand, its slowest rise on record.

We believe this significant rise in the number of jobs going to non-Saudis could be due to a change in the methodology of labor surveys conducted by the GAS. We say this since it is uncommon for the economy to have created such a high number of jobs in 2016. During the past ten years, the non-oil economy grew, on average, by 7.1 percent per year. During the same period, the economy added about 433.3 thousand jobs per year, with non-Saudis occupying 61 percent of those newly added jobs. This year, we forecast non-oil economic growth to slow to 0.3 percent, which should have a negative impact on employment growth as well.

The slowdown in the number of jobs created for Saudis (45.5 thousand), coupled with the rise in the Saudi labor force of 92.2 thousand, has led to an increase in the unemployment rate from 11.5 percent in 2015 to 12.1 percent in Q3 2016, the highest since 2012 (Figure 5). We believe that initiatives highlighted within the National Transformation Program (NTP 2020) will contribute to reducing the unemployment rate over the next four years, with the specified 9 percent Saudi unemployment by 2020 being an explicit target for policy-makers to attain. Some of those initiatives include reducing the cost difference between recruiting Saudis and non-Saudis, and promoting vocational training programs to narrow the skill mismatch between private sector demands and Saudi labor supply (Table 1). Given the latest developments in the labor market, we estimate that 717.5 thousand Saudis will enter the labor force, on a net basis, in the next four years. This supply of labor will have to be met with a total number of 832.3 thousand additional jobs (208 thousand per year) in order to achieve the targeted 9 percent Saudi unemployment target by 2020 (Figure 7).

Figure 4: Divergence between labor market and economic indicators (year-on-year change)

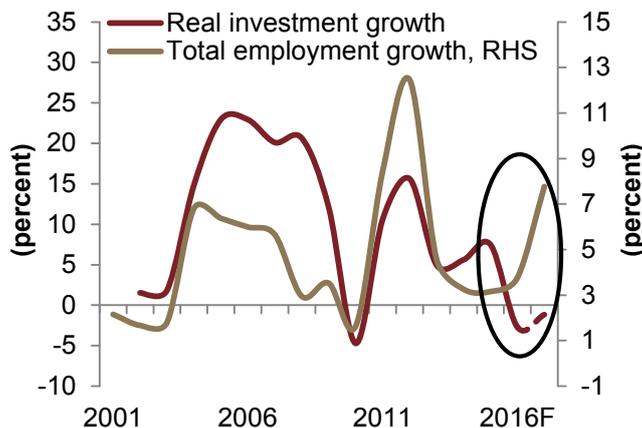
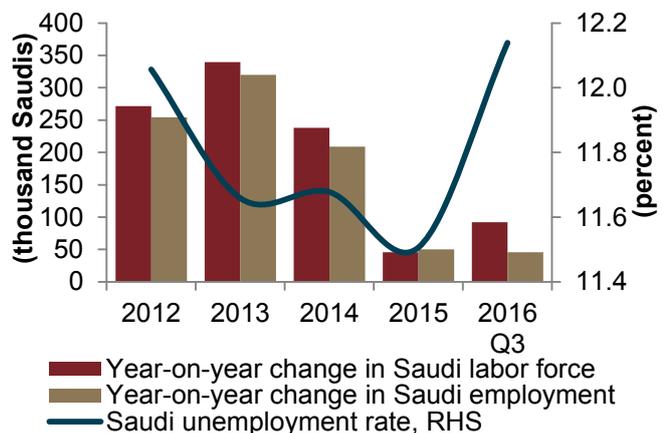


Figure 5: Saudi labor force entrants and employment





Box 1: Saudi youth and skill-matchmaking

Saudi youth aged between 20-29 years make up 31 percent of the total Saudi working-age population.

Employers showed a willingness to hire young Saudis in Q3 2016.

The recent Saudization of telecom shops appear to have positively impacted the growth in youth employment...

...while programs are currently being implemented to narrow skill-mismatches.

Between 2015 and Q3 2016, the Saudization ratio in the economy fell from 43.3 percent to 40.6 percent.

Saudi youth aged between 20-29 years make up 31 percent of the total Saudi working-age population, and are joining the labor force in increasing numbers compared with other age groups (Figure 6.1). This has caused both youth participation and unemployment rates to rise in Q3 2016 to 43.7 percent and 28.1 percent, respectively (Figure 6.2). The rising unemployment appears to have come from a large supply of bachelors degree holders, as a breakdown of unemployment rates by degree has shown a rise in that category (Figure 6.3). These developments make it necessary to prioritize structural reform in the labor market as stipulated in the NTP initiatives (see page 2).

That being said, employers showed a willingness to hire young Saudis in Q3 2016 (Figure 6.4). These new opportunities appear to have been concentrated in lower skilled/ high labor intensive sector, as hiring of Saudis with secondary degrees rose by 189 thousand, while employment of Saudis with other degrees saw a net decline (Figure 6.5).

We believe that the recent Saudization of telecom shops appear to have positively impacted the growth in youth employment during the period between 2015 and Q3 2016. We see a need for further progress, including further expansion of programs under the Technical and Vocational Training Corporation (TVTC), as well as the Ministry of Labor-sponsored "Duroob program". The Duroob program is a major initiative that specializes in catering to the needs of jobseekers, whom mostly fall under the youth age group.

In all, these programs aim to narrow the skill-mismatch between young Saudis and the private sector, and we believe success in these areas is necessary to overcome one of the most pressing labor market challenges facing Saudi youth employment.

Table 1. NTP and the labor market

Strategic Objectives	Key Performance Indicators	Key Initiatives
Develop quality standards and technical accreditation	Reduce Saudi unemployment to 9 percent	Reducing cost difference between Saudis and non-Saudis National Qualification Framework Flexible training programs Evening training programs
Provide suitable jobs for citizens	Raise the share of females in the labor force from 23 to 28 percent	Development of occupational safety in private sector Vocational rehabilitation for basic education students Directed localization
Create a safe and attractive work environment	Enroll 950 thousand students in the technical and vocational training	Establishment of national and sectoral councils Labor committees and work awareness programs Capability building in vocational training colleges
Raise Saudi skill level to match labor market needs	Raise the share of high school graduates enrolling in vocational training from 7 percent to 13 percent	Encouraging part-time jobs Development of career education and guidance Development of labor disputes resolution bodies
Increase the capacity of technical and vocational training institutions and link it to labor market needs	Reduce the percentage cost difference of employing Saudis compared to non-Saudis from 400 to 280	Develop professional assessments for technicians Provide adequate transportation for working women with suitable prices Weighted Nitaqat Payroll Management System



Figure 6.1: More young Saudis are joining the labor force...

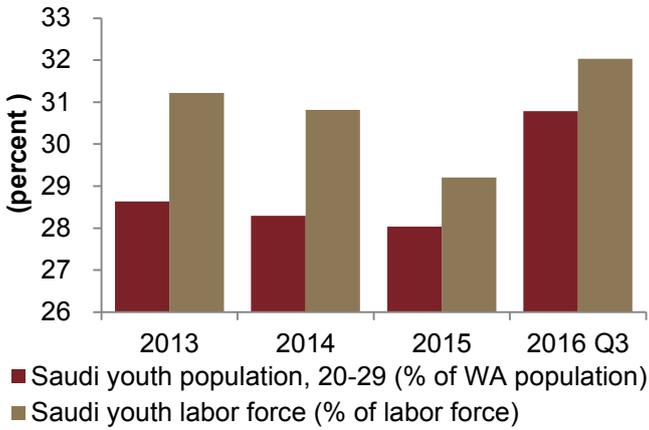


Figure 6.2: ...leading to rising levels of youth participation and unemployment...

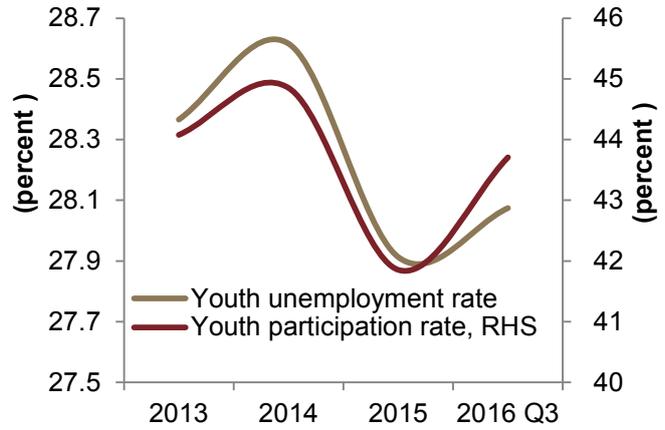


Figure 6.3: ...with most being bachelors degree holders... (unemployment rates by degree)

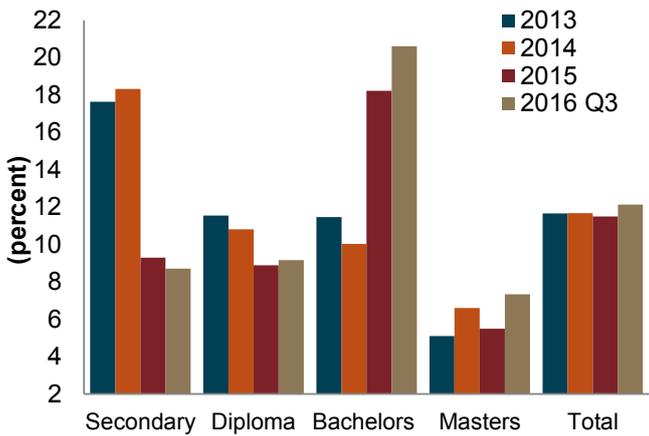


Figure 6.4: ...but total net employment of Saudi youth is rising... (year-on-year change)

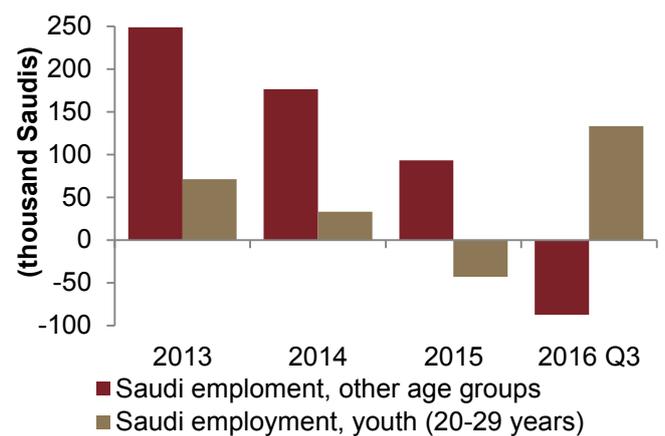


Figure 6.5: ...as employers mostly hiring secondary degree holders... (year-on-year change)

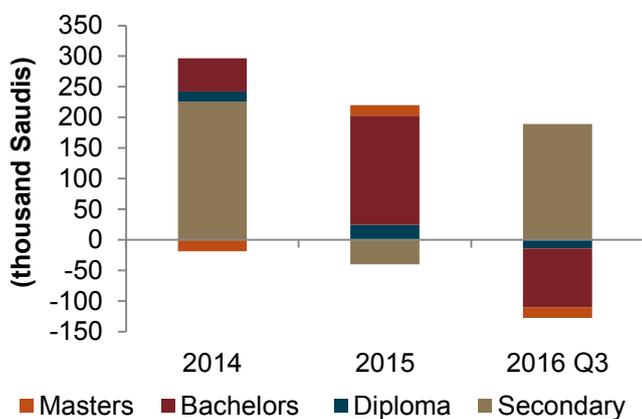
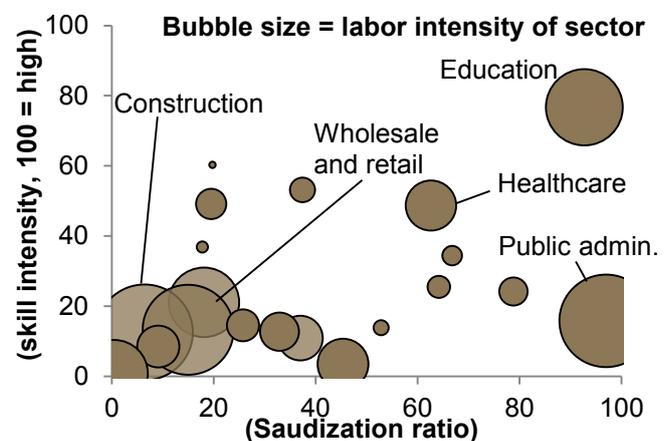


Figure 6.6: ...whilst high-skilled sectors are already saturated with Saudis





Construction has employed 652 thousand non-Saudis in nine months...

...with Saudi employment in the same sector rising by just 4 thousand.

Public admin. enjoys the highest Saudization ratio in the economy (97 percent).

Wholesale and retail added a total of 190.3 thousand jobs...

...however, 82 percent of these jobs went to non-Saudis.

Employment trends by kind of economic activity

The high growth in total employment showed an inconsistency with a slowing economy. However, this growth continued to reflect the highly segmented nature of the labor market in the Kingdom with very high employment growth going to non-Saudis. Between the end of 2015 and Q3 2016, the Saudization ratio in the economy fell from 43.3 percent to 40.6 percent (Figure 8). As the number of net job additions offered to non-Saudis rose significantly, 12 out of 20 sectors within the economy saw negative changes to their Saudization rates. That said, most of the growth in total employment came primarily from one sector, construction (Figure 9).

Construction (16.3 percent of total employment) has employed 652 thousand non-Saudis in nine months, compared with a negative net employment of 55.5 thousand between 2014 and 2015. We believe this trend is highly inconsistent with the slowing activity in the construction sector so far in 2016. The significant cut in budgeted capital spending, from SR264 billion in 2015 to only SR76 billion in 2016, and the negative growth in non-oil economic activity during the first half of 2016 are clear indicators of the slowing demand for construction. We believe this should have contributed to negative growth in sector employment as well. Meanwhile, Saudi employment in the same sector also rose by 4 thousand, but the larger growth in non-Saudi employment has caused the sector's Saudization rate to fall from 9.3 percent in 2015 to 6.4 percent in Q3 2016.

Public administration and defense (15.1 percent of total employment) is mostly associated with civil and military government jobs. This sector enjoys the highest Saudization ratio in the economy (97 percent) as the government employed a significant number of Saudis to plug the shortage of demand coming from the private sector. Between 2015 and Q3 2016, the government continued to employ more Saudis in public admin and defense, with net employment of Saudis rising by 53 thousand, the fastest pace amongst all sectors. Looking ahead, the NTP targets a reduction in public sector employment by 20 percent, which will likely result in lower employment growth in this sector over the next few years.

Wholesale and retail (14.4 percent of total employment), a sector targeted by the Ministry of Labor for Saudization, also posted a notable year-to-September rise in employment, with a net addition of 190.3 thousand jobs. However, 82 percent of these jobs went to non-

Figure 7: Jobs needed to meet NTP target

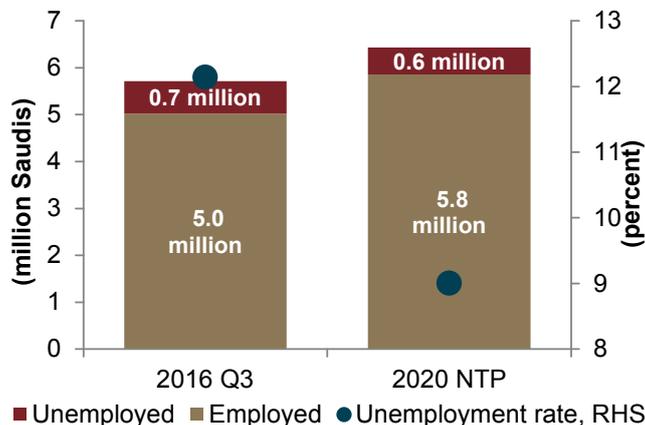
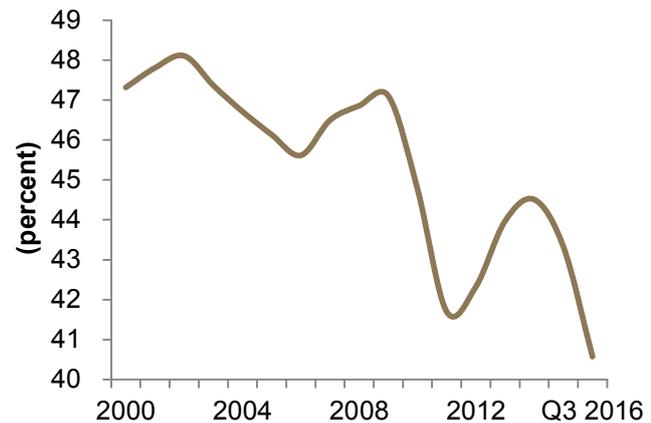


Figure 8: Evolution of Saudization in the Kingdom





Manufacturing added 117 thousand jobs, with 95.4 percent going to non-Saudis.

We forecast the Saudi unemployment rate to reach 12 percent in 2016...

...before falling back to 11.6 percent in 2017.

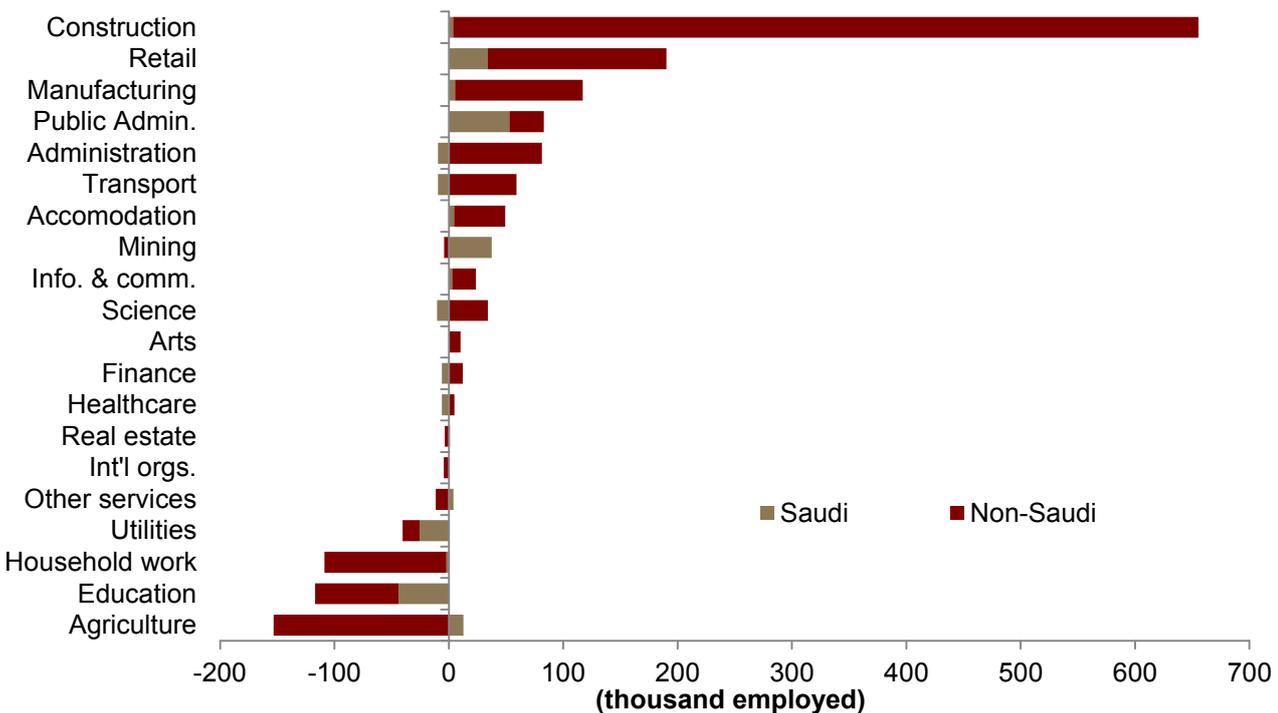
Saudis, with only 34.1 thousand jobs being created for Saudis. A similar sector targeted for higher Saudization, **accommodation and food services (3 percent of total employment)** saw a year-on-year increase of 5 thousand and 45 thousand in net employment of Saudis and non-Saudis, respectively.

Manufacturing (8.6 percent of total employment), added 117 thousand jobs, but 95.4 percent went to non-Saudis. This led to a decline in the sector's Saudization ratio from 19.8 percent in 2015 to 18.1 percent in Q3 2016. That said, quarterly GDP showed that within the manufacturing sector, non-oil manufacturing growth was negative for the first half of the year. This may suggest that the majority of growth in employment came from the petroleum refining sub-sector, which grew by 4.1 percent during the same period.

Other sectors that saw a notable increase in net employment of Saudis include mining (37 thousand), agriculture (13 thousand), and information and communication (3 thousand).

Looking ahead, we expect the implementation of several initiative in the NTP, coupled with continued labor market reform, limits to public sector employment, and changing cultural perceptions to lead to higher growth in Saudi employment, particularly in service-based sectors. These sectors span a wide range of labor-intensive activities including wholesale and retail, food and accommodation, and tourism. We maintain our earlier view that there is a skill mismatch between private sector needs and Saudi job-seekers, which will continue to be a major obstacle in reforming the labor market. Also, the segmentation between Saudis and non-Saudis in wages, work hours, and skills remains a key factor in the private sector's tendency to hire non-Saudis. That said, we forecast the Saudi unemployment rate to reach 12 percent in 2016, before falling back to 11.6 percent in 2017.

Figure 9: Employment by kind of economic activity
(2015 - 2016 Q3 net change in employment)





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