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IN THIS EDITION ...

The Saudi economy is on the verge of a breakthrough: a new expansionary budget, increasing prospects pointing to higher growth, and crude oil prices touching USD 75 per barrel are a recipe for a strong 2019.

The Ministry of Finance's preliminary budget for 2019 reveals that expenditure would soar to SAR 1.1 trillion, as the government continues to fund several programmes and implement relevant initiatives outlined in the fiscal balancing programme.

"Attention to direct the increase in expenditure as much as possible to capital expenditure, which contributes to the development of infrastructure and improvement of government services, while at the same time revitalising the economy and improving the investment environment," the ministry said, signalling that it plans to accelerate expenditure to stimulate growth.

The spending levels will rise over the next three years, but deficit as a percentage of GDP is set to narrow to 3.7% by 2021, compared to 5% this year.

The government forecast shows real GDP growth will rise to 2.3% in 2019, gradually improving to 2.4% in 2021, "as a result of the impact of structural economic reforms in the medium and long term," the ministry said.

Markit's purchasing manager's index also points to higher growth in the fourth quarter of 2018.

"We remain optimistic that sustained higher oil production will support faster expansion in the non-oil sectors in Q4, particularly manufacturing, transport and logistics," according to Markit's latest business sentiment survey. "This view appears to be shared by the majority of firms surveyed, as nearly 39% of firms surveyed expect their output to be higher in 12 months, the most since the May survey."

Other indicators are also suggesting an upturn in economic activity, including progress on major projects, such as NEOM, and completion of a major infrastructure development. The start of the high-speed rail connecting Jeddah to the Holy Cities is considered an engineering feat and is vital for the government to reach its annual target of accommodating 30 million pilgrims annually by 2030, from the current level of 20 million.

ECONOMIC TRENDS

The government has recognised that boosting public spending is vital in sustaining the momentum of its ambitious diversification plan.

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OIL & GAS

Demand forecast has been on the upside and the US dollar remains strong, leading oil prices to a steady ground.

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TRANSPORT

The new transport facility will have the capacity to carry 60 million passengers a year, boosting the kingdom's pilgrimage tourism industry.

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PETROCHEMICALS

Robust investment in downstream projects assures the kingdom of an enviable market share in the industry.

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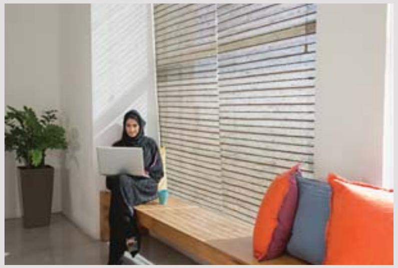

SME

Business creation is becoming a strong career choice for many Saudi nationals, which would help advance the country's shift towards a knowledge-based economy.

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COMMODITY

Threats of trade tariffs between two of the world's largest economies have triggered mixed market performance among industrial and precious metals.

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SAUDI'S 2019 BUDGET TO SPUR ECONOMIC GROWTH

The Saudi economy is expected to keep accelerating over the coming years on the back of reforms and rollout of new fiscal initiatives, according to the government's 2019 budget.

The Ministry of Finance expects Saudi real GDP to reach 2.1% in 2018, rising to 2.3% next year, 2.2% in 2020, and 2.4% in 2021 – easily its best performance in at least five years.

The ministry said it intends to balance its desire for diversification in a bid to shield the economy from volatile oil prices. Growth will come as a result of the impact of structural economic reforms in the medium and long term.

"This is in addition to the contribution of fiscal reforms impact aimed at reducing the budget deficit to gain investors' confidence, and the development programmes of some of the productive sectors announced in the Vision 2030 programmes," the ministry said.

However, the ministry noted that diversification of the kingdom's resources represents a major challenge to public finances, especially "in view of the fluctuations in world oil prices and the importance of developing non-oil revenues to ensure a stable and sustainable source of financing".

Initiatives such as the Financial Sector Development Programme (FSDP) have been implemented, while a raft of measures such as the Macro and Fiscal Policy Unit, Debt Management Office, the Spending Efficiency Realisation Centre, Fiscal Balance Programme Office and Non-Oil Revenue Development Centre are all examples of efforts being rolled out to ensure fiscal discipline, so as to keep pace with the Saudi Vision 2030 agenda.

A BALANCING ACT

The suite of measures will address fiscal challenges, as the government targets a deficit of 4.1% of GDP by 2019, which would continue to decline gradually over the medium term, until it reaches fiscal equivalent to around balance by 2023.

Government revenues are expected to jump 11% in the new budget, to reach SAR 978 billion as a number of non-oil revenues, such as valued added tax, expat levy and excise taxes, start generating income for the government.

The government expects revenues to exceed SAR 1 trillion by 2021, growing at a rate of 6% annually.

While revenues are rising, the government is conscious that spending is crucial to stimulate the domestic economy. The transformative changes demanded by new reforms also mean fiscal push to support economic growth.

The 2019 budget estimates spending of more than SAR 1.1 trillion, as the government funds several initiatives, such as the Citizen Account Programme, which provides subsidies to those who are expected to be impacted by the energy price reforms.

The Strategic Procurement Unit and the new Government Tenders & Procurement Law will also contribute to the enhanced efficiency of expenditure.

"Attention to direct the increase in expenditure as much as possible to capital expenditure, which contributes to the development of infrastructure and improvement of government services, while at the same time revitalising the economy and improving the investment environment," said the ministry.

BOOSTING INVESTOR CONFIDENCE

The preliminary 2019 budget offers a robust plan by the Saudi government to not only stimulate the economy by raising expenditure, but also boost revenues in the midst of oil prices that have been fluctuating and are experiencing some uncertainty.

"To address this challenge, the government has launched several programmes and initiatives within this scope, such as the National Industrial Development and Logistics Programme (NDC), which aims at developing the industry and local content in several sectors, e.g. renewable energy, military industries, exports and mining; as well as improving infrastructure, supporting exports and establishing the logistics services needed to enable the kingdom to be unique industrial and logistic platform between the three continents, which will help create more promising job opportunities for Saudi nationals," said Dr. Saad Alshahrani, general manager of Macro & Fiscal Policies Unit.

Other initiatives such as the privatisation programmes and structural reforms in the economy, especially in the labour market, are also expected to instil investor confidence.

The development of the non-oil sector will provide fiscal headroom, which would give the government the flexibility for interventions as and when the needs arise. As well as accelerating fiscal and economic goals, it will also deliver the ability to absorb external shocks that the economy might face, the ministry noted.

CRUDE OIL PRICES RALLY AS MARKET SEEKS STABILITY

Brent crude prices jumped nearly 5% in September, as traders began worrying about supply-side issues, especially in Iraq, Iran, Nigeria, and Venezuela, as well as the hurricanes that hit the United States.

December ICE Brent expired at USD 82.72 per barrel on 28 September, ending a strong quarter that saw the prompt North Sea benchmark up 7% from the start of July and 24% since the start of the year.

Demand is the key driver. If world consumption for crude grows this year and the next compared with last year's levels, the market will tighten in the fourth quarter and prices will continue to increase, with WTI reaching as high as USD 80 per barrel this month. Should that occur, the danger is that higher crude prices will stifle demand and the market will rebalance at a lower level early next year.

This possibility has been fuelled by the recent strength of the dollar, which increased oil prices for consumers outside the United States.

Meanwhile, the Organization of the Petroleum Exporting Countries (OPEC) are doing their part. The Joint OPEC-non-OPEC Ministerial Monitoring Committee said that members had achieved a conformity level of 129% in August this year, and 109% in July, which shows reasonable progress towards OPEC's pledge in June to adjust overall conformity to 100%.

OIL INVESTMENT

There are also concerns that producers have not invested enough in large-scale projects to ensure a steady supply of new oil.

OPEC secretary general Mohammad Sanusi Barkindo, during the 39th Oil & Money Conference in October, touched on the issue that the industry is worried about policies that detrimentally impact oil, with talk of stranded assets and declining values of oil.

"Then we have a potentially dangerous scenario, one that could increase volatility significantly. This is brought home by the scale of the investment requirements. Oil-related investments across the upstream, midstream and downstream are estimated at around USD 11 trillion in the period to 2040," the secretary general said.

OPEC expects global oil demand to grow at an estimated 1.54 million barrels per day (bpd) this year, to reach 98.79 million bpd, taking into account slower growth in OECD Europe, the Middle East and South America.

In 2019, world oil demand growth is forecast at 1.36 million bpd, down by around 50 thousand barrels per day (tbd) from last month's projections, mainly reflecting adjustments in the economic projections for Turkey, Brazil and Argentina. As a result, total world oil demand is anticipated to reach 100.15 million bpd.

Oil demand growth is expected to be led by India, followed by China, and OECD America. In 2019, OECD demand is forecast to grow by 0.25 million bpd, while non-OECD countries will drive oil demand growth by adding an estimated 1.11 million bpd.

LONG-TERM GROWTH

While renewable energy is expected to gain market share as an energy source, fossil fuels led by crude oil and natural gas will continue to be a crucial component of the global energy mix over the next few decades, with Middle East oil playing an important role in ensuring supply stability.

A long-term forecast shows OPEC countries will increase their global share to 40 million bpd or 36% of total by 2040, compared to 32 million bpd or 34% this year.

The organisation expects the world's primary energy demand to expand by a robust 91 million barrels of oil equivalent per day (mboed), or 33%, between 2015 and 2040, rising to 365 mboed.

"This is driven predominantly by developing countries, which see almost 95% of the overall energy demand growth. Most of this will come from Asia, but Africa is expected to play an increasingly important role, too," according to the forecast.

Oil demand will grow by 14.5 million bpd, or 111.7 million in total by 2040, an increase of 23 million bpd, compared to OPEC's forecast last year.

While non-OPEC countries will boost production by around 9 million bpd until 2027, their contribution will start to decline amid "losses in US tight oil production, as well as depletion in other regions, such as the Asia-Pacific, North Sea and Latin America.

The OPEC forecast expects natural gas to witness the biggest growth in absolute terms of around 32 mboed, and renewables the largest growth in percentage terms (+7.4% per annum).

"Oil remains the fuel with the highest share of the energy mix over the forecast period, at 28% in 2040," OPEC said, noting that petrochemicals will lead the demand for crude oil, on the back of rising demand for consumer goods.

HARAMAIN TO HOST 'MOST EFFICIENT' HIGH-SPEED RAIL

Saudi Arabia became home to the fastest rail link in the Middle East when King Salman bin Abdulaziz al-Saud, inaugurated the Haramain High Speed Rail connecting Jeddah to Madinah in early October.

The new project reaches speeds of 300 kilometres (km) per hour, cutting the journey time on the 450-km journey between the holy cities of Makkah and Madinah to about two hours. The line passes via Jeddah, the main port city, its airport and the nearby King Abdullah Economic City.

The project will improve the links for pilgrims, as the kingdom receives around 20 million pilgrims a year, including over 2 million during the annual Hajj pilgrimage. The project has the capacity to transport 60 million passengers annually, and will be vital for the government's target of hosting 30 million pilgrims a year by 2030.

The number of pilgrims reached 2.37 million in the recently concluded Hajj season, according to the General Authority for Statistics, which is a logistics and transportation feat.

"The station in the economic city seeks to serve people of the three cities, pilgrims and Umrah performers via the high-speed rail in addition to provide various services, including business, shopping, stores, restaurants, hotels and entertainment as well as pivotal projects in the future, including establishment of a global oasis joining a museum for Islamic history," according to the government.

'MOST RELIABLE HIGH-SPEED TRAIN'

The railway is intended eventually to operate as an important component of a national and regional rail network. The kingdom's existing rail network is mainly focused on mining, bringing phosphates and bauxite from the north to industrial cities on the Gulf, and shipping freight from Dammam on the Gulf to Riyadh.

The project is considered an engineering feat as it is fully electric and features 46 rail bridges, nine wadi bridges, and five rail underpasses, in addition to 53 vehicular overpasses, 30 vehicular underpasses, 12 camel crossings, five stations, and three depots.

The USD 7 billion project was awarded in 2011 to a Spanish consortium, with railcars provided by Spanish manufacturer Talgo, which was commissioned to provide 35 trains for the service.

The company, which is responsible for providing maintenance for the next 12 years, said designing and manufacturing the Talgo 350 for the project required the development of many patents including guaranteeing protection from sand and dust, passenger comfort and safety in extreme climates, and ways to reduce wheel and rail wear in the desert.

"Due to its design, the Talgo 350 for Saudi Arabia is the most efficient and reliable high-speed train available today," Talgo said.

NEW PROJECTS

The kingdom's logistics upgrade continues apace with King Abdullah International Airport in Jeddah also moving from trial to operation phase.

The latest transition of the project will start from November to December, during which all domestic flights will be received at the airport, which will be fully operational from January to March 2019. By then the airport will welcome domestic and international flight through 46 gates, according to the General Civil Aviation Authority.

The Public Investment Fund also announced the launch of Amaala, a luxury destination on the north western coast of the country.

"The PIF has announced that Amaala will sit alongside NEOM and The Red Sea Project as part of the giga-projects investment portfolio, helping to establish a unique tourism ecosystem, supporting economic diversification and creating high-value job opportunities. The development area will span 3,800 sq km and will be easily accessible via a dedicated airport," the company said.

The project will also feature a strong marine infrastructure, as it aims to emerge as a new destination on the Mediterranean Sea, and be dubbed as "the Riviera of the Middle East."

Meanwhile, the kingdom completed 55 road projects valued at SAR 4.9 billion during the first half of the year, spanning 1,689 km, according to the Ministry of Transport.

In addition, a number of road projects are on the way.

"The projects approved during the first half of this year amounted to 468 projects with total length of 12,592 km, amounting to more than SAR 42 billion," the ministry said, adding that "the total number of projects signed for the year 2018 to date reached 70 projects with a total value exceeding SAR 2.4 billion, covering all regions of the kingdom."

SAUDI DOMINATES GLOBAL PETROCHEMICALS RACE

The Middle East will be one of two regions in the world that is expected to raise petrochemicals capacity over the long-term, according to a new report by the International Energy Agency (IEA).

The Middle East enjoys a strong competitive advantage over other regions, thanks to its abundant natural gas supplies, which can produce low-cost ethane – a key petrochemical ingredient.

In the longer run, Asia and the Middle East – led by Saudi Arabia – will increase their market share of high-value chemical production by 10 percentage points, while the share coming from Europe and the United States decreases. By 2050, India, Southeast Asia and the Middle East together will account for about 30% of global ammonia production.

The IEA report noted that the Middle East is generally at the lower end of the cost curve among regions for primary chemical production. Currently, it has 12%, 9% and 15% of the world's production capacity for high value chemical (HVCs), ammonia and methanol, respectively.

"The region is thought to have strong potential growth. Of the region's total crude oil production (about 28 million barrels per day), only about 7 million bpd is refined locally, with the rest exported to global markets. Over 90% of naphtha output is also exported rather than being used locally as feedstock, partly as a result of the ample availability of far cheaper alternatives, such as ethane and LPG, which together make up more than half of regional HVC feedstock," the IEA said in its report.

Indeed, the Middle East has headroom to grow, as its level of petrochemical/refinery integration is low compared to other regions.

DOWNSTREAM INVESTMENT

In May, Abu Dhabi National Oil Corporation (ADNOC) announced plans to invest USD 45 billion in developing one of the world's largest refining and petrochemical facility by 2025 in the Al Ruwais Industrial City.

"We will invest significantly in Ruwais and open up attractive partnership and co-investment opportunities along our extended value chain to create a powerful new downstream engine and springboard for growth that will benefit our country, our company and our partners," said Dr. Sultan Ahmed Al Jaber, UAE minister of state and ADNOC Group CEO.

"Importantly, the expansion plans for Ruwais will also support Abu Dhabi and the UAE's economic development and diversification, create high-skilled jobs and enhance the country's status as a globally attractive destination for energy investments."

Saudi Aramco and SABIC have announced a large crude-oil-to-chemicals project of 400,000 bpd capacity, five times the size of the only similar facility operating now, ExxonMobil's plant in Singapore. The Saudi project is expected to come onstream in the mid-2020s.

Saudi Aramco is also developing a proprietary technology, based on thermal cracking of crude oil to produce chemicals, which promises a 70% to 80% yield of chemicals. A commercial design is expected to emerge by 2019.

"Whether such technology will spread to other regions is uncertain. In oil-importing regions, the margins from direct crude-oil-to-chemicals processes will be lower, due to inherently higher energy requirements (relative to standard technologies) and transport costs for the feedstock," the IEA said. "Concurrently, Saudi Aramco is also pursuing other avenues for growth in its petrochemical operations."

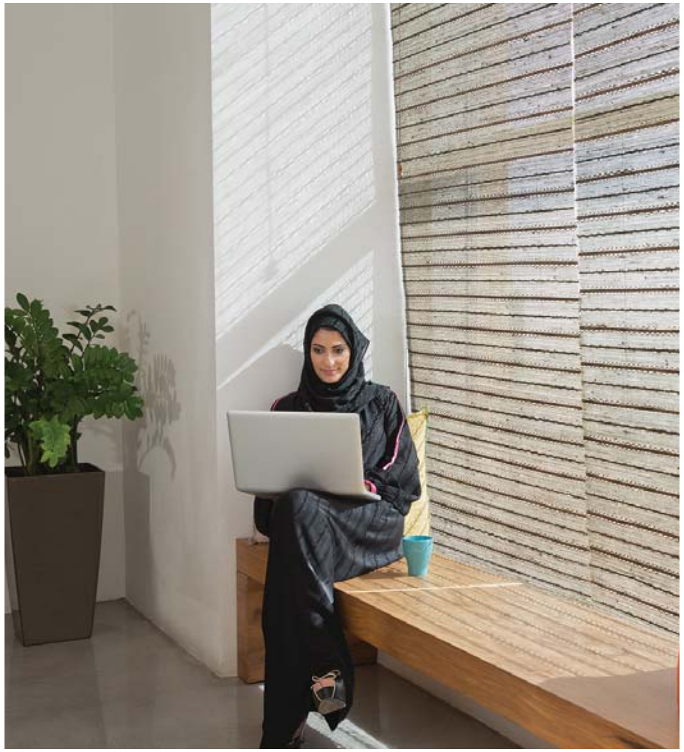
EYE ON ASIA

SABIC is also cementing its position in the growth markets of China and India. In September, SABIC signed a memorandum of understanding (MoU) with the Fujian Provincial Government of the Republic of China, which sets out the framework of co-operation between the two parties to enable SABIC to develop a world-scale petrochemical complex located in Fujian. The MoU does not have a definitive timelines.
The MoU is part of SABIC's strategy to diversify its operations, seek new investment opportunities and strengthen its position in the Chinese market.

In India, SABIC aims to build on its 25-year presence in the country and participate in the South Asian nation's 'New India 2022' initiative, which aims to boost the 'Made in India' brand.

"With an investment of more than USD 100 million in the Technology & Innovation Centre in Bengaluru – one of the largest investments in India by a Saudi company, the focus has been to build research competencies to support growing market needs in India and SABIC worldwide," said SABIC, noting that India's chemical sector is projected to grow at an annual rate of 8% to 10% annually to reach USD 300 billion by 2025.

SAUDIS EMBRACE ENTREPRENEURSHIP: SURVEY



A new survey shows Saudi Arabia has a moderate-to-high cultural affinity for entrepreneurship.

"Around 60% of the working-age population would prefer that everyone had a similar standard of living, nearly 70% of the same population consider starting new businesses to be a good career choice and that success earns social status and respect," according to a new report on Saudi perceptions to building businesses published by Global Entrepreneurship Monitor.

"Also, a high proportion perceive media as paying attention to new business creation, that it is easy starting new businesses, and that many businesses aim primarily to solve social problems."

GEM was established in 1999 as a joint project between United States' Babson College and the United Kingdom's London Business School, with the mandate to understand why some countries are more 'entrepreneurial' than others. The institute provides research to organisations such as the United Nations, World Economic Forum, World Bank, and the Organisation for Economic Co-operation and Development (OECD).

Saudi citizens' perceptions about entrepreneurship show high regard for the vocation and is a positive development in the wake of increased entrepreneurial activity expected in the coming years.

The GEM survey highlights two perceptions that stand out in particular. First, is the low proportion of individuals fearing failure as an obstacle to start-up, and, secondly, the high percentage of people perceiving good business opportunities over the next six months in their local area.

However, the good disposition and entrepreneurial characteristics of a population are not sufficient in themselves to generate significant levels of contribution to the economy from the entrepreneurial sector – many other factors, likewise analysed and evaluated across this report, come into play.

The GEM report also noted that while most SMES typically start off with few employees, in Saudi Arabia early-stage entrepreneurial activity is better positioned compared with other economies in the region, because the percentage of such activity with no employees is very low. Currently, 47.1% of activities have more than five employees in 2017, compared to 36.6% in 2016.

Still, there is much work to be done, as while Saudi perceptions of entrepreneurship and starting out on their own is high, many businesses still need support from the government.

The survey showed that new business activity in the market (or those running from three to 42 months), saw a drop from 7.7% in 2016 to 6.7% in 2017.

BIG BUSINESSES SUPPORT SMALL BUSINESSSES

For its part, the Saudi government has pledged to launch a raft of new initiatives to raise the economic contribution of small and medium enterprises (SMEs) through initiatives, such as the National Entrepreneurship Programme and the Strategic Partnerships Programme, aimed at strengthening the role of the private sector, according to the Ministry of Finance.

The authorities have pledge to provide "the necessary support to these companies, opening greater horizons for expanding their business locally and abroad, and the creation and consolidation of economic and investment relations between countries of common interests through the building of global partnerships to promote the strength of the economy and diversification of industries," the Ministry of Finance said in its preliminary budget 2019.

Major government-related entities are also supportive of the SME sector.

Aramco said it had identified 140 SME development opportunities across nine industrial segments, with a more than USD 16 billion market gap, a fraction of its USD 400 billion capital programme over the next decade.

"Local content development is ultimately about sustainability, driven by the better integration and agility that come from sourcing our value chain from our own backyard," according to Ahmad A. Al-Saadi, senior vice-president of technical services at Aramco.

"By helping create quality jobs, building an innovative workforce and stimulating economic growth, localisation aligns with the economic and social aims of Vision 2030, the kingdom's economic diversification programme."

Similarly, Saudi Arabian Basic Industries Corp. (SABIC) has launched a Local Content and Business Development Unit (LCBDU), which aims to position the petrochemicals giant as a key enabler of Saudi Vision 2030.

"The LCBDU leads SABIC's national initiative NUSANED, an integrated localisation engine that empowers collaboration between the SMEs, large multinationals and the government in Saudi Arabia by supporting the national industrial sector and, allowing national companies to become global," the company said.

ESCALATING TRADE WOES SEND SHOCKWAVES THROUGH METALS

Commodity prices are facing headwinds, such as subdued growth, in key emerging economies of China and India. A brewing trade war between the United States and China, and a strengthening US dollar have made commodities more expensive for importing nations.

China's manufacturing purchasing managers' index (PMI) fell again in September, but industrial metals prices rose as the country's anti-pollution measures are now likely to be applied less harshly. Meanwhile, the US-China tariffs were not as high as feared, which helped riskier assets, such as emerging market equities and industrial metals.

The International Monetary Fund recently downgraded the economic prospects of the US and China – the world's two largest economies.

"Notwithstanding the present demand momentum, we have downgraded our 2019 US growth forecast owing to the recently enacted tariffs on a wide range of imports from China and China's retaliation," the IMF said.

"China's expected 2019 growth is also marked down. Domestic Chinese policies are likely to prevent an even larger growth decline than the one we project, but at the cost of prolonging internal financial imbalances," the fund added.

INDUSTRIAL METALS

Amid the prospects of slow growth, industrial metals were a mixed bag in September. Zinc was the star performer as it rallied on the back of further drops in stocks, along with the potential easing of Chinese anti-pollution curbs on heavy industry.

Zinc inventories in London Metal Exchange-registered warehouses fell below 200,000 tonnes, from more than 250,000 tonnes in August, and are nearing 10-year lows. The fall has helped the commodity surge 17% to USD 2,678 a tonne, since its 22-month low in August.

A major sell-off in zinc prices from USD 3,575 per tonne in February to USD 2,300 per tonne by mid-September (-35%) saw Chinese zinc producers step in and restrict output, while consumers start to build refined stocks.

By the end of June, a number of large Chinese smelters had committed to cutting production by 10% and appear to be following through on this threat, with year-on-year output declining 6% over the two months to August, domestic and bonded stocks drawing down sharply, and

bonded premiums spiking.

The 6% rebound in copper to USD 6,200 per tonne from its early September low of USD 5,800 per tonne has been accompanied by several tightening physical indicators, especially in China. Chinese bonded copper premiums have increased at a pace only matched twice in the last five years, to USD 120 per tonne, robust Chinese spot premiums are incentivising a drawdown of bonded stocks, and SHFE and LME curves have tightened.

Trackable global copper inventories in days of consumption have fallen to their lowest levels in nine years, and are drawing at a faster than normal pace for this time of year. Furthermore, this is not just Chinese consumer stocking – as initially thought – following the collapse in prices from USD 7,300 per tonne in June.

Aluminium is also emerging as a US-China trade story, especially after the Asian giant boosted tax rebates on the metal's export to offset the impact of the US tariffs.

Last month, China increased its rebate on value added tax (VAT) for exports of semi-fabricated aluminium, or semis, to 16% from 13%, senior analyst Greg Wittbecker of consultancy CRU told Reuters.

PRECIOUS METALS

Palladium was one of the best performers last month as part of a relief rally associated with lower than expected impact of US tariffs on China. Palladium was trading at USD 1,079.40 per ounce, and appear to have better fundamentals than gold, surging 27% from a year-to-date low of USD 845.60 in August.

Gold prices briefly hit USD 1,200 per troy ounce in September but have retreated below that figure amid pressure from a stronger dollar and a higher US interest rate outlook.

"The selling interest is being limited by the shaky stock market worldwide and strength of the dollar is limiting the upside," said Kitco Metals senior analyst Jim Wyckoff, as reported by Reuters.

Higher interest rates boost the dollar and push bond yields up, putting pressure on gold by increasing the opportunity cost of holding non-yielding bullion.

Against a basket of major currencies, the greenback hit a seven-week high, boosted by rising US bond yields.

The yellow metal has been trading in a USD 30 range over the past 50 days, which suggests that investors continue to seek a safe haven in the midst of economic growth in emerging markets and inflationary pressure from soaring oil prices.

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