جدوى للإستثمار
Jadwa Investment

June 2021

Monetary and Financial Update

Ample levels of liquidity

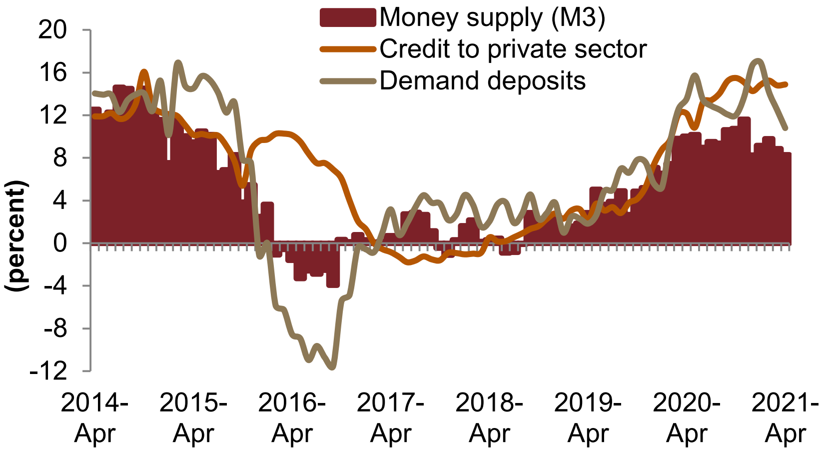
Key Indicators
Yearly percentage change (year-to-April)

Indicator	Year-to-April 2021	Year-to-April 2020
M3	8.9	8.5
Credit to private sector	15	10.7
Claims on public sector	12.6	18.1
Private deposits	9.4	4.3
Loan-to-deposit ratio*	76.7	79.2

**Period average*

- **Monetary Policy - Global:** The US Federal Reserve (Fed) kept the Federal Fund Rate (FFR) steady at a range between 0 to 0.25 percent since the early days of the pandemic in March 2020. In a meeting last week, the Fed outlined that it now expects to see interest rates rising earlier than previously anticipated, with two hikes expected in 2023.
- **Monetary Policy - Domestic:** Accordingly, we expect to see the Saudi Central Bank (SAMA) following the Fed's decision, with no change in rates in the near term.
- **Money Supply and liquidity:** In the year-to-April, the broad measure of money supply (M3) was up by 8.9 percent, compared to the same period last year, primarily as a result of a rise in total demand deposits.
- **Bank Claims:** Total bank claims rose by 14.1 percent year-to -April, year-on-year, as credit to the private sector (which accounts for 75 percent of total bank claims) rose by 15 percent compared to same period last year.
- **Mortgages:** New residential mortgages provided by banks totaled SR62 billion in the first four months of the year, up 58 percent over the same period last year.
- **New Letters of Credit (LCs):** After a slowdown in 2020, latest data shows new LCs jumped in April, mainly driven by higher LCs for the importation of vehicles.
- **Looking ahead**, a continued improvement in the local economy during H2 2021 will have a positive impact on credit to the private sector, but could result in mild rises in local funding rates. At the same time, we do not expect to see any changes in SAMA's repo and reverse repo rates in the near term.

Figure 1: Monetary indicators
(year-on-year change)



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Global Monetary Outlook

The Fed held the FFR steady at a range between 0 to 0.25 percent.

In its most recent meeting last week, the Fed kept policy rates unchanged at a range between 0 to 0.25 percent, and asset purchases at $120 billion a month. At the same time, the Fed raised its growth projections for the US economy from 6.5 percent to 7 percent in 2021, and for inflation from 2.4 to 3.4 percent. In-line with this, recent data releases show that the economy is improving, with unemployment falling to 5.8 percent in May (compared to 13 percent in May last year) and wages rising by 0.5 percent month-on-month (compared to a decline by 1.1 percent in May 2020). In addition, recent data (for May) showed a sharp rise in inflation of 5 percent year-on-year (Figure 2). All of this combined, had raised concerns that the US economy could be entering a period of sustained price rises, which, in turn, would move the Fed to reconsider its current loose monetary policy stance. However, in its latest meeting in June, the Fed kept its inflation expectations for 2022 unchanged, indicating that, in their view, current inflationary pressures were temporary. Accordingly, current surveys suggest the US FFR is not expected to change anytime in the near future (Figure 3). That said, the Fed did revise its outlook regarding interest rates over the medium term, with expectations of two hikes in 2023, which is earlier than previously anticipated.

Latest data showed US inflation is rising, and job market is improving…

...with no expectations of rising the FFR in the near future.

The ECB maintained its monetary stimulus package, to keep the pace of the economic recovery.

Within the European Union (EU), the European Central Bank (ECB) is also facing the prospect of higher prices, with inflation hitting 2 percent in May, hitting the ECB's target (of 2 percent) for the first time in more than 30 months. In its latest meeting, the ECB maintained its monetary stimulus package in a bid to help maintain the pace of the economic recovery.

Meanwhile, the BoE is expecting to see inflationary pressures, especially in the housing market.

In the UK, the Bank of England (BoE) is also watching inflation rates as the economy gears up to come out of lockdown as a sizable proportion of the population is vaccinated. In addition, the BoE is expecting inflationary pressure from the housing market, with UK house prices hitting multi-year highs due to pent-up demand and reduced government (stamp duty) fees related to property purchases.

China's producer prices jumped by 9 percent in May, year-on-year, marking the biggest rise in 13 years.

Latest data from China shows the economy has seen one of the fastest economic recoveries in the world since being hit by the first wave of Covid-19. Meanwhile, China's producer prices jumped by 9 percent in May, year-on-year, driven by higher commodity prices and a lower base effect after being in negative territory for most of last year. The rise marks the biggest increase in 13 years, and is likely to

Figure 2: US inflation rate
(year-on-year)

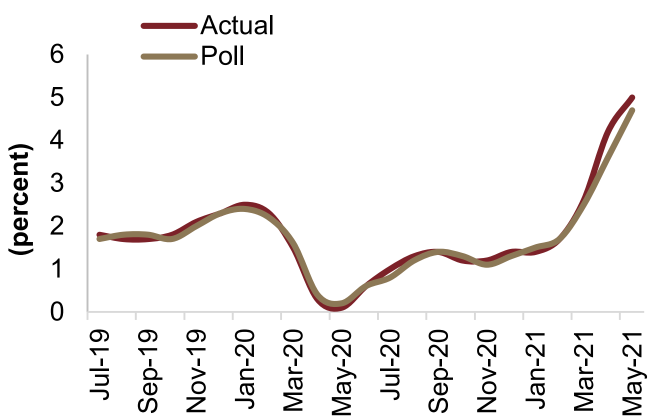
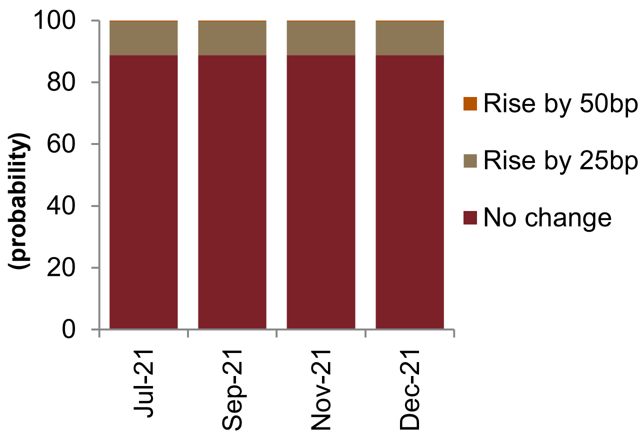


Figure 3: Probability of US interest rate rises
(survey of expected rise in FFR in basis points by date)



lead to cost push inflation on Chinese exports to most parts the world.

Saudi Monetary and Financial Outlook

SAMA has kept the reverse repo and repo rates unchanged, in-line with the US Fed's interest rate decision.

Since the rate cut at the beginning of the pandemic back in March 2020, the Saudi Central Bank (SAMA) has kept the reverse repo and repo rates unchanged at 0.5 percent and 1 percent respectively (Figure 4), in-line with the US Fed's interest rate decision. SAMA simultaneously implemented a SR50 billion program to support the private sector (*detailed in our macroeconomic update*), which provided sufficient liquidity within the banking sector. In-line with this, SAIBOR (the price of lending between banks for Riyals) has been gradually declining since March 2020, and is currently at the lowest rate in six years.

SAIBOR has been gradually declining since March 2020, reaching the lowest rate in six years.

Money supply, liquidity and deposits

In the year-to-April, M3 was up by 8.9 percent, mainly affected by the rise in demand deposits.

In the year-to-April, the broad measure of money supply (M3) was up by 8.9 percent, compared to the same period last year, primarily as a result of a rise in total demand deposits (which make up 60 percent of M3). The trend in total deposits seems to have been positively impacted by strong growth in private sector demand deposits (88 percent of total demand deposits), which rose by 12.7 percent on a yearly basis in the year-to-April. Meanwhile, government demand deposits were up by 21.7 percent in the year-to-April, with a visible rise seen even before the onset of the pandemic.

Time & saving deposits decreased in the year-to-April, with declines coming from both private and government time deposits.

On the other hand, time & saving deposits decreased in the year-to-April, compared to same period last year. Declines were seen in both private time & saving deposits (53 percent of total time & saving deposits) by -0.4 percent, and government time & saving deposits by -8.1 percent during the same period. The decline in private time & saving deposits (which was more pronounced throughout most of 2020) may partly reflect increased appetite by local investors in channeling their savings towards higher yielding investment opportunities. For example, TASI is currently trending close to multi-year highs, having risen by 40 percent since June of last year (*please refer to our latest chartbook*), whilst average daily traded values have more than doubled over the last year or so. Moreover, the real estate market has witnessed a rebound in activity as well, with the total amount of real estate transactions rising from SR5.6 billion in May 2020 to SR15 billion in May 2021.

Figure 4: Market Rates in Saudi Arabia

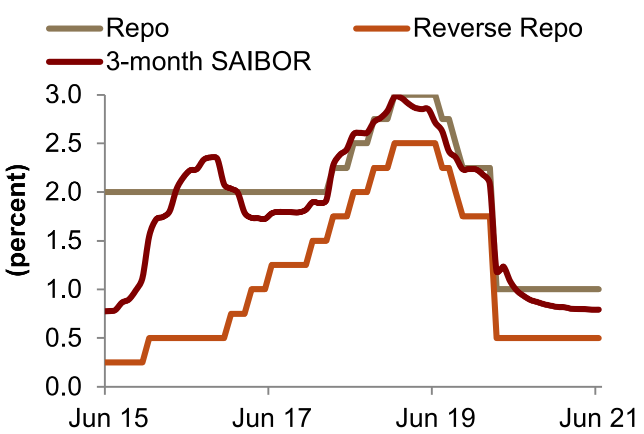
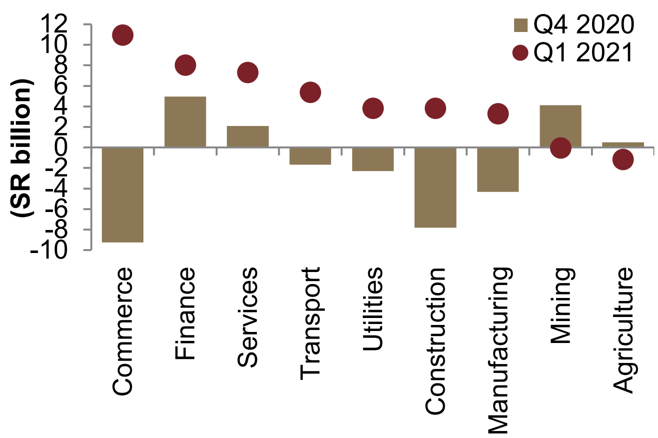


Figure 5: Change in Bank Credit, by Sector
(change in Q1 2021 vs. change in Q4 2020)



Bank claims

Bank claims rose by 14.1 percent year-to-April, supported by a rise in credit to the private sector.

Total bank claims rose by 14.1 percent year-to-April year-on-year, supported by an increase in credit to the private sector (75 percent of total bank claims) by 15 percent year-on-year, and, to a lesser extent, by a rise in claims to the public sector, by 12.6 percent.

Higher levels of credit are expected to be directed to sectors that remain under precautionary measures.

Moreover, despite the significant rise in total credit to the private sector, there has been a great deal of variance within sectors. Latest credit data showed net new credit rebounding in Q1 2021 quarter-on-quarter in all sectors aside from 'agriculture' and 'mining'. As we noted in our *the Saudi Economy in 2021* report, higher levels of credit are expected to be directed to sectors that remain under precautionary measures related to Covid-19. In-line with this, 'commerce' and 'services' saw some of the highest rise in net new credit during Q1 2021 quarter-on-quarter (Figure 5).

The share of SME loans in total bank credit reached 8.4 percent by the end of Q4 2020.

Looking at latest data on banks lending to small and medium enterprises (SMEs), the share of SME loans in total bank credit reached 8.4 percent by the end of Q4 2020 (up from 6 percent in Q4 2019), with a significant rise in lending seen towards medium size enterprises (Figure 6). Meanwhile, credit card loans declined in Q4 2020 (for the first time since 2011) and then again in Q1 2021, by 4 & 13 percent year-on-year, respectively (Figure 7). The decrease is likely correlated with lower demand for international commercial travel, tourism and entertainment activities.

Mortgages

In the year-to-April, new residential mortgages rose by 58 percent.

A total value of SR62 billion in new residential mortgages loans were issued in the first four months of the year, equivalent to a rise of 58 percent year-on-year. Looking at loans by property type, 'villas' still represent the majority of mortgages, at 80 percent of the total. Related to this, in the year-to-April, the Ministry of Housing's (MoH) Sakani program provided 66 thousand housing units to citizens, representing 44 percent of the targeted 150 thousand units by the end of 2021.

New Letters of credit

New LCs declined by 2 percent in the year-to-April 2021, improving from a decline by 10 percent in 2020 overall.

New letters of credit (LCs) by commercial banks to the private sector enterprises declined by 2 percent in the year-to-April 2021, compared to the same period last year. Despite still being in the negative territory, there has been a significant improvement over 2020 totals (when LCs declined by 10 percent overall). More specifically, latest data showed new LCs jumped in April, mainly driven by higher LCs

Figure 6: Credit to SMEs

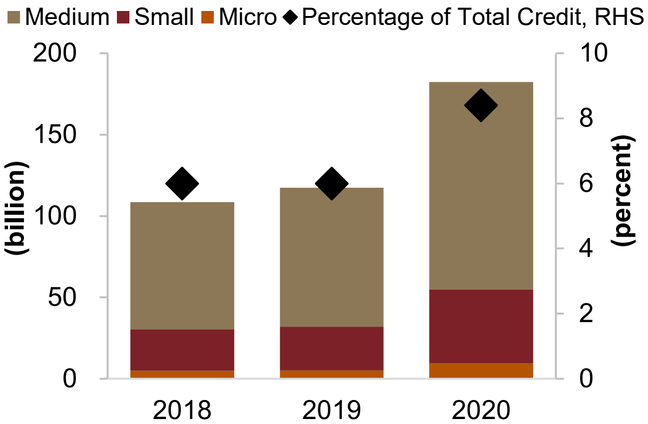
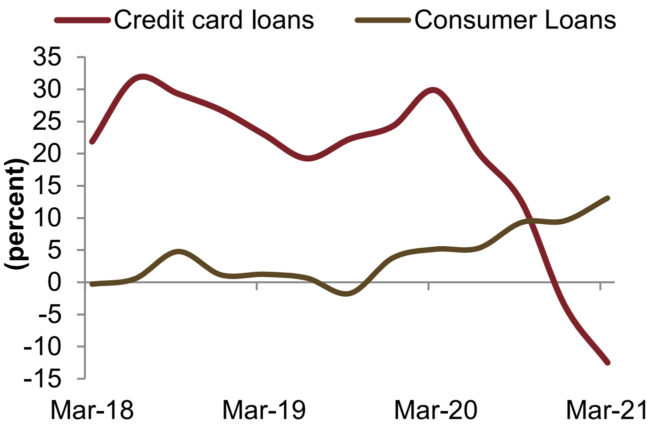


Figure 7: Credit card loans
(year-on-year change)



NPLs rose from 1.9 percent in 2019 to 2.2 percent in 2020…

...especially in commerce, construction and manufacturing sectors.

Looking ahead, the continued improvement in the local economy in H2 2021 will have a positive impact on credit to the private sector.

Also, continued positive investor sentiment could further erode deposit growth.

for the importation of vehicles (Figure 8).

Financial soundness indicators

Data on the banking sector showed that non-performing loans (NPLs) as a share of total loans hit the highest level since 2011, at 2.2 percent at the end of 2020, versus 1.9 percent at the end of 2019. According to SAMA, NPLs in 'commerce', 'construction' and 'manufacturing' saw the largest rises in 2020. NPLs are likely to deteriorate marginally in the near term, not only because of continued challenging economic conditions for certain companies and sectors, but also because two major initiatives by SAMA (the deferred payments program and a SR50 billion zero-interest one-year deposit at banks) are set to expire at the end of June 2021. Meanwhile, other indicators from the banking sector ,such as return on equity (RoE) and return on assets (RoA) also declined during 2020, amid low interest rates, and a slowdown in business activity during the pandemic (Figure 9).

Outlook

Looking ahead, the continued improvement in the local economy during H2 2021 will have a positive impact on credit to the private sector. Latest GDP data showed that the non-oil private sector grew by 4.4 percent in Q1 2021, compared to 1.6 percent a year ago. In addition, the latest non-oil PMI rose to 55.2 in May, its highest reading in five months, as business activity, new orders and local demand all rose. Beyond the near term, we also expect to see an expansion in lending for the next phase of Vision 2030, as recently unveiled Vision Realization Programs for 2021-2025 are implemented *(please refer to May's edition of our chartbook)*. In addition, the recently announced 'Shareek' program, which aims to forge a partnership between the public sector and certain listed private sector companies, will substantially raise the level of bank financing needed to meet the target of investing SR5 trillion in new investments by 2030.

With respects to private sector deposits, as restrictions around social distancing are relaxed, in-line with higher level of vaccinations, more spending opportunities for households are likely to arise, especially in relation to services. In addition, continued positive investor sentiment could further erode deposit growth. As such, we expect the build in private deposits at banks to slow, or even reverse for some time during 2021.

Figure 8: New letters of credit (LCs)
(year-on-year change-smoothed 3-month average)

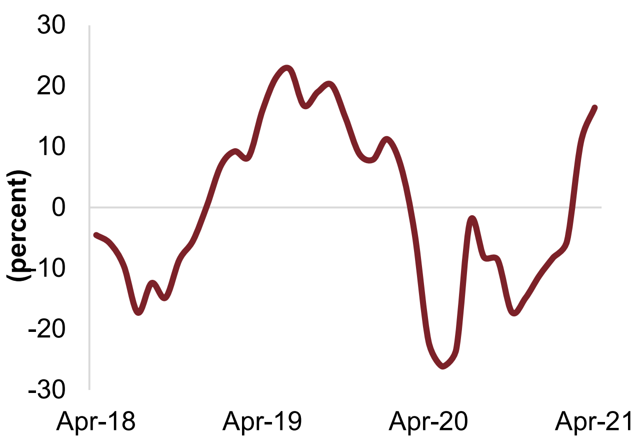
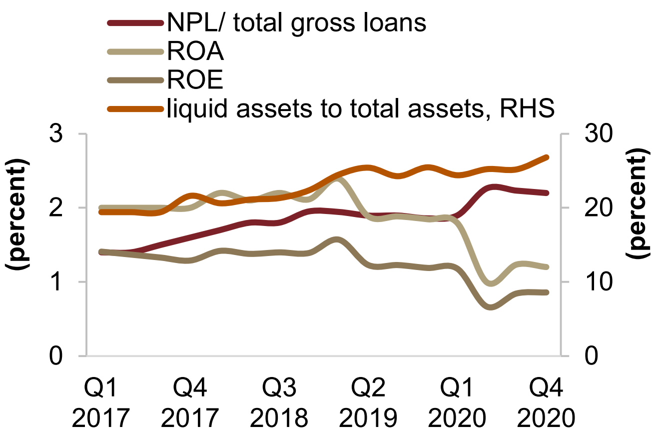


Figure 9: Selected financial soundness indicators in the banking sector



We do not expect the Fed to raise the FFR in the short term.

In-line with this, we expect SAMA to keep key repo and reverse repo rate unchanged in the foreseeable future.

Despite many positive developments in the US economy, including a rising trend in prices, we do not expect the Fed to raise the FFR in the short term. In-line with this, we expect SAMA to keep key repo and reverse repo rate unchanged in the foreseeable future. That said, we do nevertheless expect to see some rises in SAIBOR in the near term. As noted above, higher demand for credit, declining private sector deposits and expiration of some of SAMA's programs, are expected to add to moderately tighter liquidity conditions in the near term.