



MENA ECONOMICS UPDATE

SAMA likely has more to do to ease liquidity concerns

- **Reports that the Saudi Central Bank (SAMA) has injected liquidity into the banking sector appears to be a consequence of a lack of FX intervention (despite high oil prices), tight fiscal policy and strong credit growth. SAMA appears keen to sustain robust lending growth, but that will probably require it to maintain its focus on providing liquidity to banks, rather than draining it, over the coming months.**
- *Bloomberg* reported this week that SAMA had deposited approximately SAR50bn (\$13bn or 4.6% of Saudi GDP) as time deposits with commercial banks to ease a liquidity crunch in the banking sector. The funds were provided at a discount to the three-month interbank rate (SAIBOR) and transferred prior to the Fed's 75bp hike earlier this month. The move came after the spread of the three-month SAIBOR over the US interbank rate widened to its largest level since early 2017.
- **Up until the mid-2010s, Saudi had a large surplus of liquidity in its banking sector** (i.e. banks have more reserves than are required to meet their reserve requirements). That largely reflected foreign currency invention by SAMA. High oil prices had resulted in Saudi running large surpluses on both the current account – it averaged 16.7% of GDP between 2008-2014 – and the financial account (excluding reserves).
- In order to prevent the currency from appreciating (and to preserve the dollar peg), SAMA purchased foreign currency from banks – increasing SAMA's total assets. As it did this, it credited commercial banks' reserves at SAMA – ensuring a like-for-like rise in SAMA's total liabilities. All else equal, this would lead to an expansion of the monetary base. To stop an unwarranted loosening of monetary conditions, SAMA sterilised these newly-created reserves by issuing SAMA bills (which are bond-type instruments) to banks.
- **After oil prices collapsed from mid-2014, however, excess liquidity in the banking sector shrunk.** (See Chart 1.) The plunge in oil prices led to a sharp fall in oil export receipts and there was a large outflow of capital from the Kingdom. The sum of the current account and financial account (excluding reserves) flipped into a deficit.
- This meant that SAMA was now in a position that it was forced to intervene to sell FX reserves in order to maintain the dollar peg. This, in turn, caused SAMA to debit banks' reserves (through the same process described above but in reverse). All else equal, this would cause the monetary base will contract. However, SAMA allowed commercial banks' holdings of SAMA bills to mature, offsetting the downwards impact on the size of the monetary base and preventing monetary conditions from tightening.
- **What's unusual this time around is that liquidity concerns have arisen against the backdrop of high oil prices which have resulted in a large current account surplus.** There are a couple of reasons why this has happened. First, SAMA does not appear to have been intervening in the foreign exchange market – FX reserves have been effectively flat since early 2020. (See Chart 2.)
- What appears to be happening is that the current account surplus is being recycled into the Public Investment Fund (PIF, the sovereign wealth fund) to finance investments abroad). Indeed, balance of payments data show that portfolio investment outflows from Saudi Arabia have increased from less than 1% of GDP in 2016 to nearly 7% of GDP by the end of last year. (In other words, rather than SAMA acquiring foreign assets, the PIF is doing so.)
- **The second reason is that high oil prices have, so far at least, not prompted the government to loosen fiscal policy.** Finance Minister Mohammed al-Jadaan [recently said](#) that the government will accumulate the Kingdom's sizeable oil windfall in its current account at SAMA, rather than increase spending, until the end of the year. After that period, these funds would be used to replenish the government's fiscal reserves (on



the liabilities side of SAMA’s balance sheet) and any remaining funds transferred to PIF. (The key point here is that when the government increases spending, its account at SAMA is debited as it transfers funds for goods or services. Banks’ accounts at SAMA are credited as a result, which expands the monetary base.)

- **Without FX intervention or looser fiscal policy lifting banks’ reserves, rapid credit growth since mid-2017 (see Chart 3) means that banks have had to convert more of their excess reserves at SAMA into statutory reserves** (those they are legally required to hold as reserves). Banks’ excess liquidity in May fell to its lowest level since 2006. (See Chart 1 again.) And the process is likely to have happened more quickly at some banks and, as a result, they have fallen into a liquidity deficit and have been forced to turn to the interbank market to secure funding to meet their reserve requirements.
- The issue now facing these banks is the cost of liquidity has risen sharply – the three-month SAIBOR has increased over 200bp since the turn of the year and stands well above the repo rate (SAMA’s standing facility used to provide liquidity to banks, see Chart 4).
- **There are perhaps two key takeaways here. First, SAMA appears concerned that rising interest rates could slow credit growth.** It will need to raise interest rates by virtue of the dollar peg. But it seems to be taking steps to mitigate the rise in the cost of liquidity for banks. SAMA only raised interest rates by 50bp this month, rather than following the Fed with a 75bp increase, and the recent liquidity injection was provided at an interest rate below the SAIBOR rate.
- **Second, if SAMA wants to sustain strong credit growth, it will have to increasingly shift its focus to providing liquidity to the banking sector.** Liquidity in the banking sector could improve if PIF is instructed to scale back its investments abroad and/or the government loosens fiscal policy. If that is not forthcoming and banks want to sustain strong credit growth, more banks will face a liquidity deficit.

Chart 1: Excess Liquidity of Commercial Banks* (% of Total Commercial Bank Assets)

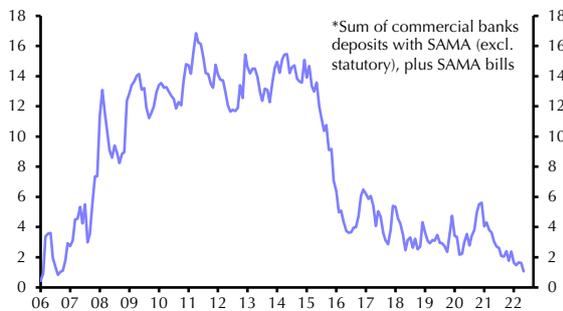


Chart 2: Saudi Central Bank FX Reserves (\$bn)

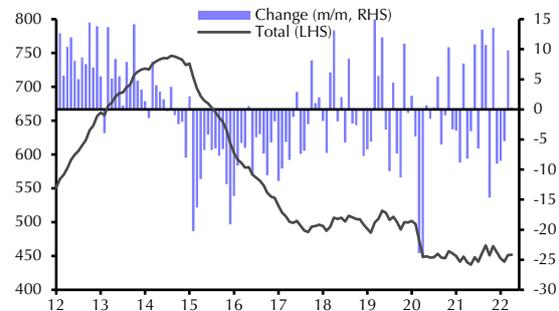


Chart 3: Broad Bank Credit* (% y/y)

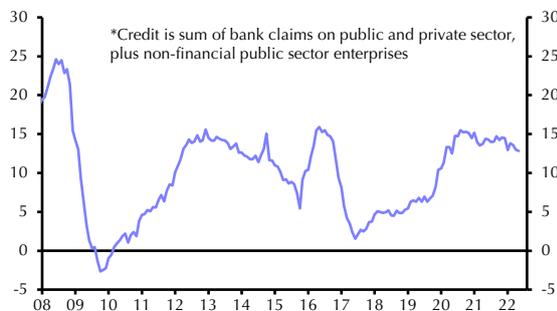
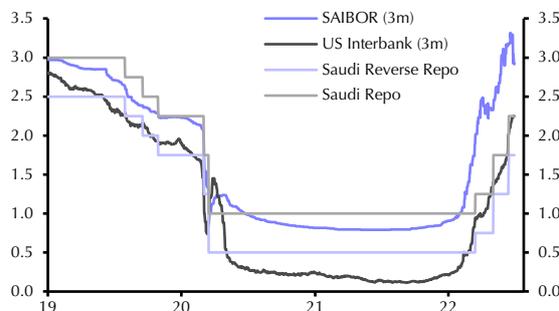


Chart 4: Interest Rates (%)



Sources: CEIC, Saudi Central Bank, Refinitiv, Capital Economics



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