Monthly monetary indicators
Project finance pipeline supports credit, bank deposits grow

- Private sector credit growth gains for fifth month in May
- Bank deposits post first rise in three months, signal upturn
- SAMA builds up foreign assets despite oil price volatility
- Broad money supply growth still lowest since 1999 but stabilising

A series of new financing deals concluded and in the pipeline continue to support improvement in Saudi bank private sector credit growth, which in May rose for a fifth month to its fastest pace of expansion in nine months. The latest central bank data support our view that momentum is building behind an economic recovery in Saudi Arabia; bank deposits increased for the first time in three months, the central bank added to its foreign asset holdings, money supply growth – while still weak – is showing signs of stabilisation, and new letters of credit are being opened to accommodate greater trade flows.

Bank claims on the private sector expanded by an annual 3.9% in May to SR753.422 billion, the fastest growth rate since August 2009, the Saudi Arabian Monetary Agency’s (SAMA) monthly bulletin shows. Credit growth is still comparatively subdued after annual growth exceeded 30% for many months in 2008. Still, loan growth has consistently risen since December, when private sector claims bottomed, contracting almost 2% month on month and 0.04% year on year.

May private sector claims included a 3% annual increase in bank credit (loans, advances, overdrafts, and bills discounted) and 3.5% rise in private security investments, although these eased slightly from the month earlier. We expect positive credit trends to continue in June and throughout the second half as a sequence of project finance deals trickle through the banking system. The bulk of new loan growth stems from extension of long-term credit maturing in three years or longer, according to SAMA. This is not surprising as banks are beginning to engage in project financing deals in energy, power and infrastructure.
Saudi Aramco and Total in June completed a $8.5 billion financing deal for a joint refinery project of which banks provided $4.49 billion. A number of other deals have also reached fruition in June: SABIC secured a $1 billion loan from state-owned Alinma Bank; four Saudi banks provided $600 million to Saudi Electricity Company as part of a joint venture power plant funding project; and Saudi mall operator ACCL Arabian Centres said it was seeking a $1.08 billion loan from local banks.

While the government has been shouldering the financing burden for strategic projects in the past year and half, banks look poised to take a greater slice from now on as they abandon some risk aversion. Bank claims on the public sector eased for a second month in May, although they are still up 10.9% year to date. According to our estimates, the potential project finance pipeline for the remainder of the year exceeds $44 billion. Hence, while credit growth could fluctuate during the summer months, particularly in August which coincides with the holy month of Ramadan, we expect moderate growth rates to continue in the second half of 2010. Our annual private sector credit growth forecast is 8%.

Cumulative bank profits are increasing, which is a good sign, although year on year, the Saudi banking sector’s profit was still lower than last year in May. We expect provisioning against potential bad loans will be lower in 2010 than in 2009, which – along with stronger credit growth – could lead to higher net income for the banking sector this year.

Better times

Other monetary indicators also look more sanguine. The monetary base fell in May, after a healthy pick up in April, although it is likely to improve in the coming months. When the monetary base rises it signals a bettermment in the banking sector’s ability to generate fresh loans.

M2 money supply growth expanded by an annual 5.8% in May after growth rates fell in the prior three months. Growth in broad money, or M3, moreover, resumed at 0.9% month on month in May following a contraction in April, although the annual 2.6% growth rate was the slowest since 1999. The May rise in money supply is a good sign that the economy is growing. We anticipate money supply growth rates will accelerate along with private sector credit growth in the second half of the year, averaging 7% for the full year.

Higher growth is not without potential consequences, however, and any acceleration in money supply growth should be monitored to see how it will bear on inflation. Inflation accelerated to 5.4% in May with the rise mainly stemming from higher costs for food and continued steep increases in rents. The inflationary pressures (demand-pull inflation) are in large part supply related and any change in monetary policy at this juncture will not have a significant impact on prices.
Underpinning the health of the economy, bank deposits rose 1.1% in May to SR921.71 billion, having contracted in the prior two months, although individual and business clients are still opting to keep funds in liquid, demand deposit form, than savings deposits. This trend has been encouraged by a low interest rate environment and the tendency among businesses to draw on their cash positions for immediate working capital needs as bank credit availability tightened.

Lower foreign currency holdings of businesses and government entities had been the main driver of declines in overall deposits in the first part of 2010. In May, this trend reversed, with deposits in foreign currencies rising 2.2% from April levels. Time and saving deposits grew by a slim 0.1% to SR307.982 billion in May from April, while demand deposits rose 1.5% to SR464.99 billion. Demand deposits at Saudi banks are up 7.3% year to date and time and savings deposits are down 4.8% at SR307.98 billion. Banks have not aggressively striven to build up deposits recently because they have ample liquidity and are not lending aggressively. The loan-to-deposit ratio, which had fallen as low as 77% in December, stood at 78.6% in May, down slightly from April’s 79%.

A tendency toward risk aversion is likely to continue as banks vet loan requests – other than those linked to the government’s strategic infrastructure projects – with caution. Claims on the public sector declined in May but there has been an upward trend since December which could represent a gradual step away from the state self-funding its own projects. The small drop in May can also represent the
government’s repayment of its outstanding loans. SAMA has upheld a policy of keeping its reverse repurchase rate at 0.25% in a bid to encourage banks to lend their surplus funds. But risk-averse banks have tended to park their cash abroad instead; between January and May, banks’ net foreign assets climbed 23.5% to SR104.94 billion, after surging 36.9% in 2009. Saudi bank deposits held in the central banks reverse repo window declined 17.9% year on year in May, following similar drops in March and April. This could indicate that banks are deploying more funds in the domestic economy while also searching for investment opportunities outside.

As domestic economic conditions improve, consumer demand is also recovering, necessitating greater imports. New LCs to finance imports rose 9.4% month on month in May to SR14.07 billion, a 59% annual gain. This is linked to a rise in LCs opened to finance imports of motor vehicles, machinery and appliances, although LCs for building material, foodstuff and other goods imports all fell in May.

Global volatility risks

Greater global economic uncertainty in light of the euro-zone sovereign debt crisis and volatile oil prices has tempered optimism about how quickly the Saudi economy will recover. Business leaders surveyed in Banque Saudi Fransi’s third-quarter business confidence index were less confident about the financial outlook in Q3, although most assume the domestic implications of euro-zone troubles will be slight.

Despite a sharp volatility in oil prices for much of the month of May, SAMA net foreign assets resumed month-on-month growth at 0.5%, having contracted for the first time in seven months in April. The central bank’s foreign assets grew at an annual rate of 5.2%, the fastest expansion in a year. Despite dropping from above $86 a barrel in early May to the mid-$60 level by mid month due to the euro-zone crisis, oil prices in May still averaged $74 a barrel – a level that supports big public spending outlays. SAMA has been investing its surplus funds in foreign securities, with holdings of these up SR83.56 billion year to date, the data show. In May, they stood at SR1.16 trillion, a 1.2% month-on-month rise.

By contrast, SAMA has been drawing on its deposits with banks abroad, which are down SR44.97 billion so far this year, standing in May at SR290.71 billion, a dip of 1.4% from April. While public spending will continue to remain high, we still expect Saudi Arabia to post a fiscal surplus in 2010 amounting to 3% of GDP.
Disclosure appendix

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