Monetary Watch

November 11, 2010

Monthly monetary indicators

Saudi loan growth still weak, liquidity and deposits strong in September

Private sector credit posts slight gains in September, deposits jump
Money supply growth at 7-month high, but little inflation pull
SAMA foreign assets up almost 11%, biggest advance in 17 months
Trade, consumer activity slowed amid Ramadan, Eid celebrations

The bank lending atmosphere in Saudi Arabia remained relatively stationary in September, with only a slight pick up in private sector credit growth taking place even as money supply growth improved to a seven-month high and deposits made their biggest monthly gains since early 2009. Data of the Saudi Arabia Monetary Agency (SAMA) show that in September, which corresponded with the end of the holy month of Ramadan and a holiday to mark the Eid Al-Fitr celebration, commercial and consumer activity was subdued.

The world’s top oil exporter continued to benefit, however, from robust oil prices, which averaged $77 in August and $75.50 in September, enabling the central bank to build its net foreign assets by almost 11% in the year to September. At a time when private sector lending activity is muted, the state’s ability to finance key expansion projects without drastically deteriorating its fiscal position is crucial. In late October, for instance, the state-run Public Investment Fund granted SR4.88 billion in financing to joint venture Saudi Aramco Total Refining.

SAMA numbers highlighted yet again the banking sector’s wariness and vigilance toward new lending as well as subdued demand for credit from the private sector. Claims on the private sector accelerated 3.6% year on year to SR773.17 million, including a 0.8% increase from the month earlier. Growth in claims on the private sector had fallen from 4.9% in July to 3.3% in August. Without a big turnaround in the fourth quarter, growth in private sector claims may fall slightly short of our 8% forecast for the year. Stripping out investments in private securities, outstanding bank credit to the private sector grew 2.6% in September, from 1.7% in August – again underpinning hesitation among the country’s banks. Bank credit grew 4.4% in the first three quarters; between 2005-2009, it had surged almost 70%.

Public sector credit picks up in September, private credit stagnant

![Private sector credit and credit to public sector enterprises](chart.png)
Credit to public sector enterprises, meanwhile, jumped nearly 18% in September, including a 9.6% gain from August, to SR33.94 billion. Government agencies are bearing the brunt of the financing burden for strategic projects in infrastructure, energy and utilities, so the rise in lending by more than 20% in the first nine months of the year is not surprising. The government granted 3,184 contracts worth SR101.2 billion for construction and education projects alone in the first three quarters, according to Ministry of Finance data.

Subdued lending caused the banking sector’s loan-to-deposit ratio to fall to 81% in September from 82.6% in August as loan growth failed to build momentum as quickly as deposits, which expanded 4.8% year on year. Demand deposits, which do not pay interest and are easily accessible, have been favoured this year due to the low interest rate environment, although their pace of growth in September was slower than deposits in time and savings, and foreign currency accounts, data show. Demand deposits expanded 0.9% from August, while time and savings deposits grew 3.8%, and foreign currency deposits jumped 10.9% from the month earlier. Demand deposits still make up 51.9% of total deposits in Saudi banks, up from 41.8% at the beginning of 2009. Over all deposit growth of 3.2% from August was the fastest month-on-month increase since February 2009.

The recovery in credit expansion is taking longer than earlier anticipated, but the gradualist approach is more prudent than the exuberance practiced by many banks prior to 2009. We are unlikely to see a return of double-digit rates of credit growth before 2012 and 2013, when private sector appetite picks up following a period of deleveraging.

Bank liquidity, money supply improves

Reinforcing the pace of bank credit growth remains a key challenge for the Saudi banking system, although sentiment on the outlook for loan accessibility is gradually improving. The proportion of business leaders who described banks’ lending attitude as “not good” in the fourth-quarter BSF Business Confidence Index fell sharply to 21% in Q4 from 46.5% in Q3 – and almost 60% in Q1. The credit scenario is likely to recuperate in 2011 as a greater volume of project financing deals comes on stream, although a majority of respondents to the survey said banks had tightened requirements for loan approvals to businesses and households “substantially” in the past year.

For the time being, banks are looking for other ways to invest their liquidity aside from lending it. Banks’ investments in foreign assets jumped 34.2% between January and September, including an 11.1% month-on-month rise in September. The money banks held in the central bank’s reverse repo window, meanwhile, surged 38.7% in September from August, having dropped by a similar amount in the prior two months.

Money supply growth in Saudi Arabia has also been extremely sluggish this year after almost tripling between 2005 and 2009. Growth in broad money (M3) made a good comeback in September, rising 2.7% from the month earlier and 5.1% year on year, the fastest growth since February. M2 money supply growth rose to a 10-month high of 8%. The monetary base, including highly liquid currency in banks and held by the public, also rose 3.4%, although the money multiplier fell to 4.63 in September. Monetary base growth indicates that additional capital is being held in bank coffers and less deployed in the economy. Despite this, private sector credit grew SR6.69 million in September resulting from a lag in the two prior months.

Subdued money supply growth rates have not be an important trigger of inflation in recent months, nor do we expect it to be in the medium term. Inflation – driven by food prices, higher rents and steeper goods and services costs – is likely to average 5.3% this year, exceeding 2009’s 5.1%. Inflation rates are on a declining path in our view due to peaking food prices and rents, base effect adjustments and the stronger dollar moderating domestic inflationary expectations.
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Consumer, trade indicators weak; foreign assets swell

Trade and consumer activity, meanwhile, looked weaker in September than during the summer months. The number of point of sale transactions fell 9.3% in September from the month earlier and their overall value slumped 14.7% to SR5.6 billion, according to SAMA data. Since a good degree of transactions continue to take place using cash rather than plastic cards, point of sale data are not an entirely accurate barometer for consumer activity, but can be taken as an indication. The final 10 days of Ramadan, in addition to a several-day celebration to mark the end of the holy month, fell in September, which could explain the drop in POS transactions, as well as the 30% drop in the value of personal cheques from August to SR31.6 billion.

The value of letters of credit signed to finance imports also provides an indication about the health of trading activity. In September, year on year growth in new LCs was only 4% to SR9.5 billion, the lowest level for any month in 2010. This development corresponds with the 7.1% decline in imports recorded that month by the Central Department of Statistics & Information. The value of LCs for food imports was the lowest this year in September, while LCs for cars, building materials and machinery also posted declines, according to the data.

As the monetary situation struggles to pick up, SAMA continues to build a cushion of foreign assets that will enable the state to shoulder the economic recovery effort until a good revival takes place in the private sector. Net foreign assets held by the central bank, which fell during much of 2009, gained 10.9% in September to SR1.58 trillion ($421.83 billion) – the highest level since February 2009. SAMA has been building deposits with banks abroad, which are up 22.9% from a year ago. Bank deposits can be easily drawn down by the state to finance its budget. We expect Saudi Arabia could face a slight fiscal deficit this year as it supports a projected 20% overspending of budgeted expenditures, according to our forecasts. The revival of oil prices above $80 a barrel in November may enable the government to break even on its budget, however. Investments in foreign securities, which make up 73% of total foreign assets, grew 8.2% in September, the data showed.
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Loan-to-deposit ratio still far from peaks

September sees big drop in consumer indicators

Money multiplier dips off 21-month high

Oil price sustains upward momentum above $80 in November

Dollar begins to rise again after a sharp drop

Banks park money abroad while lending subdued
Disclosure appendix

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