Monthly monetary indicators
Money supply resumes growth in June, deposits and loans strengthen

- Broad money supply accelerates for the first time in nine months in June
- Private sector credit higher as banks grant long-term project loans
- Bank deposits extend rise, demand deposits account for 51% of total deposits
- Commercial bank foreign assets up 11% m-o-m

Robust public spending outlays and a moderate return in private sector activity supported stronger money supply and credit growth in Saudi Arabia in June, according to the latest central bank data. The Saudi Arabian Monetary Agency’s monthly bulletin showed broad money supply (M3) growth accelerated on an annual basis after eight consecutive months of slowing growth that had taken year-on-year expansion in M3 to its slowest pace since 1999 in May. Oil prices at or above $75 a barrel continue to enhance confidence and create fiscal assurance in the kingdom, although a slowdown in new letters of credit shows that trade flows continue to be volatile although imports are recovering.

Bank credit growth, while improving, continues to fall far short of double-digit levels of 2007 and 2008 as banks continue to adopt a watchful attitude toward extending new credit and demand from the private sector remains subdued. Most of the new credit growth this year has been linked to projects in which the government is the key stakeholder. The state has shouldered the project financing burden in the last year and a half, drawing on its foreign asset holdings due to a slowdown in private sector activity. While Saudi Arabia has adopted the largest fiscal stimulus as a share of GDP in the G20, it remains to be seen is when the private sector’s investment appetite will pick up.

A good signal in the June data was a 3% annual rise in private sector bank credit (loans, advances, overdrafts and bills discounted) to SR728.31 billion, on par with its growth in May. As recently as January, annual credit growth was below 1%, so the turnaround in June is notable as it marks the sixth month of growth in private sector bank credit. We expect an incremental increase in private sector claims in the second half will support our forecast for annual growth of 8% by December. There are some minimal and short-term downside risks to credit growth in August and September due to the holy month of Ramadan, when business activity tends to slow down.

Bank claims on the private sector rose almost 1% in the month to June to SR760.35 billion – while year on year, the growth rate of 4.4% was fastest in 10 months. That figure includes bank credit and an 8.5% monthly rise in private security investments.
In June, SABIC secured SR4.5 billion in financing from National Commercial Bank, while Aramco and France’s Total completed $8.5 billion in financing in for their joint refinery at Jubail, 47% of which was financed by state-linked entities. A healthy projects pipeline will continue to support modest rates of credit growth for the remainder of the year. Petrochemicals firm Saudi Kayan has said it would seek bank credit to help bridge a $2.4 billion rise in building costs for a petrochemical complex.

Since most new credit has gone toward projects rather than shorter-term working capital needs of private firms, loans carrying long-term maturities have accounted for the biggest share of new credit growth this year. Loans maturing in three years or longer expanded 10.5% between January and June, compared with growth of 2.4% for loans maturing in one to three years and 0.4% growth in credit maturing in less than one year. Almost a quarter of total credit is now long-term, up from less than 22% falling into that category a year ago.

Credit to public sector enterprises rose almost 10% in the month to June to SR31.26 billion, having contracted 5.3% in May. Year on year, public sector credit was down 8.7%.

Bank deposits also posted healthy growth in June. Total deposits rose 2.3% in the month to SR943.16 billion – taking them back to end-2009 levels. In three of the first six months in 2010, deposits had declined as businesses and government entities reduced their foreign currency deposits. This trend reversed in May and June in conjunction with the strengthening of the U.S. dollar against
the euro, which in turn supported the dollar-pegged Saudi riyal. After falling 22.6% in the first four months of 2010, foreign currency deposits grew 5.1% in May and June.

The low interest rate environment, meanwhile, has continued to support deposits in accessible, non-interest bearing demand deposits in favour of time and savings deposits, SAMA data show. Demand deposits accounted for 51.4% of overall deposits at the end of June, compared with 46.1% in December and 42.6% a year earlier. In June, demand deposits grew 4.2% from May to SR484.51 billion, up 24% year on year, SAMA data show. Time and savings deposits, alternatively, declined year on year for the eighth straight month, falling 12.7% in June to SR304.05 billion, off 1.3% from May levels.

The growth in deposits has not, meanwhile, been matched by higher lending. Saudi Arabia’s loan-to-deposit ratio fell slightly to 80.5% in June from a seven-month peak of 82.3% in April. The loan-to-deposit ratio, which hit as low as 78.4% in December, had risen above 90% in late 2008.

**Upturn in money supply**

M3 grew 3.4% year on year to SR1.04 billion, a 2.3% expansion on the month earlier – the biggest month-on-month improvement in 16 months. In our view, annual growth in M3, which fell as low as 2.58% in May, will pick up pace in the second half of the year along with credit growth, for an average rise of 7% for the full year. The pace of money supply growth is not high enough to trigger additional inflationary pressures, although it will support prices in the short term.

From January to June, growth in M3 averaged 4.5%, compared with 14.2% in 2009 and 21.2% in 2008. The kingdom’s monetary base – which includes highly liquid currency in bank deposits and held by the public – also grew 2% in the month to June to SR229.88 billion, up 7.3% year on year. This upturn could signal a recovery in the money multiplier in the larger economy. An increase in the monetary base if met with an increase in the money supply and bank credit is not concerning. The monetary base had been on a decreasing trend since February which should be taken as a positive sign.

With oil prices holding above $75 a barrel, SAMA has been able to keep building its store of net foreign assets, although in June the central bank drew them down 0.2% from May. Oil prices averaged $75 a barrel in June and they are on track to rise at above $76 a barrel this month. These levels support stimulatory public spending and raise expectations the government will post a fiscal surplus this year in line with our expectation for a budget surplus of 3% of GDP.
SAMA’s net foreign assets stood at SR1.56 trillion at the end of June, up 6.6% from the year earlier. Foreign assets are still SR106 billion lower than they were at a peak in November 2008, but SAMA quickly replenished its holdings this year as oil prices returned to healthy levels. SAMA has drawn down its foreign assets periodically to finance a stimulatory deficit-spending programme. In June, SAMA drew down its investments in foreign securities by 0.9% while it boosted deposits with banks abroad by 1.7%.

Prudence prevails

In a signal that commercial banks are also unwilling to part with liquidity, their net foreign asset holdings grew 11% month on month to SR116.46 billion, the highest level at any point in the last two and a half years. Bank deposits in the central bank’s reverse repo window expanded 1.4% to SR73.4 billion.

Banks’ tendency to place their excess cash with the central bank and abroad rather than lend it underscores the continuation of a cautious attitude that continues to burden their profitability. Cumulative profits of Saudi banks, weighed by slow loan growth and higher provisioning, fell 12.2% in the second quarter, according to SAMA data. Saudi banks had taken steep provisions in the second half of 2009 which we do not expect will be repeated this year. The worst has passed and there are unlikely to be more negative bad debt surprises. Non-performing loans as a proportion of total loans have increased from 2.1% in 2007 to 3.3% now – but these rates are lower than the UAE (4.6%), Kuwait (9.7%) and Bahrain (3.9%) according to IMF estimates.
Monetary Watch

July 28, 2010

Some Saudi companies have been searching for alternative sources of funding as the size and build up of their credit facilities could merit diversification. Contractor Saudi Binladin Group raised SR700 million in a short-term sukuk in July, although this might not necessarily signal a return to public debt markets in the latter part of 2010. The economy is still waiting for the private sector to deploy its resources to create a sustainable increase in real output. A possible “utilisation” gap could be created if the private sector takes too long to pick up forcing the state to keep shouldering most of the investment burden.

An upward trend in retail and consumer spending is also notable in the SAMA data. The value and volume of point of sale transactions is strengthening, with the value growth in June rising to 43.6% year on year, the highest level of the year. The number of cheques registered in June also rose, data show.

Saudi Arabia remains vulnerable to swings on global markets although it is well cushioned. New letters of credit opened to finance imports fell 15.4% in the month of June to SR11.91 billion, down 6.2% year on year. That follows five months of double-digit growth in new LCs. The June decline can be linked to a lower value of LCs for building material imports, which fell 23.3% in June from the year earlier and were 33.8% less than May. LCs for machinery imports were also down 17.7% in the year to June. These declines are likely due to seasonal factors and inventory trends rather than resulting from currency fluctuations.

Foreign trade flows are likely to fluctuate throughout the second half of the year, with full-year figures likely to be moderately better than last year. The kingdom’s current account surplus should amount to 7.5% of GDP this year, up from 6.1% in 2009, according to our forecasts. All in all, the latest monetary indicators paint a sustainable recovery picture that should take greater hold in the second half of the year.
**Monetary Watch**

**July 28, 2010**

**Retail indicators look positive**

- Point of sale transactions
- Commercial and personal cheques

**Foreign assets dip slightly in June**

- SAMA net foreign assets
- Investments in foreign securities
- Deposits with banks abroad

**Monetary base growing slowly**

- Monetary base
- Money multiplier

**Oil price stabilises above $70**

**Euro regains some ground against dollar**

- Short-term
- Medium term
- Long term

**New credit skewed toward longer-term maturities**
Disclosure appendix

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