



Saudi Monetary Update

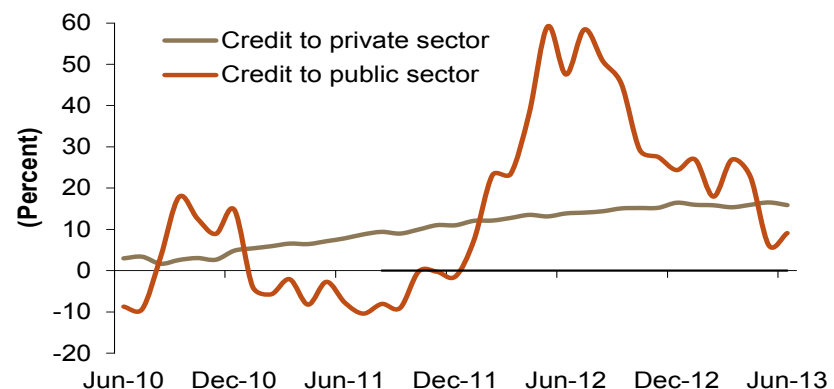
Credit expands, but not deposits

- Net credit issued to the private sector increased by SR13.9 billion to record an annual growth of 15.9 percent in June.
- Total deposits slipped by SR3.6 billion in June pushing the annual growth down to 14.4 percent. The loan-to-deposit ratio rose to 81.5 percent.
- SAMA's reserve assets slipped by SR2.4 billion in June. Foreign assets were relocated from deposits with banks abroad to investment in foreign securities and in foreign currencies.
- Bank excess deposits contracted to SR56 billion in June, though they are still higher than a year earlier, reflecting the strong liquidity position of the domestic banks.

Monetary aggregates slowed in June

Monetary aggregates continued to show solid growth reflecting strong economic performance, albeit at a slower pace than in previous months reflecting a seasonal trend. Growth in broad money (M3) slowed to 14 percent year-on-year (-0.2 percent month-on-month) in June from 16 percent in May. The narrower M2 measure, which includes demand deposits, time and savings deposits and currency outside banks, also slowed to 14.3 percent year-on-year (0.2 percent month-on-month) in June versus 15.6 percent in May. The slower growth in both measures reflect a slower growth in demand, time and saving deposits, which increased 14.8 percent year-on-year (0.2 percent month-on-month) in June down from 16.2 percent in May. The growth of monetary base also decelerated to 11.3 year-on-year as the monthly measure contracted by 6 percent. While this monthly contraction may partly reflect a seasonal trend,

Figure 1: Bank credit
(year-on-year change)



For comments and queries please contact:
Fahad Alturki
Head of research
falturki@jadwa.com

Head office:
Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com



All measures of money supply slowed in June.

Monetary base contraction may signal slower credit growth in the coming months.

SAMA's foreign assets contracted in June despite improvement in crude oil exports in the previous few months...

...but we expect the trend to be reversed in the next few months, though at a lower pace than in 2012.

A slight decline in gross foreign assets brings bank NFAs down...

...but bank aggregate external position remained strong in June.

the size of the monthly contraction may signal a slower credit growth in the coming months. The monthly contraction in monetary base is also reflected by lower bank deposits with SAMA as banks allocate more funds to treasury bills and credit to private sector. At the same time, currency outside banks remained flat in June compared to previous month, but was 10.5 percent higher than a year earlier. Given such monetary dynamics, the money multiplier maintained its upward trend recording 4.9 percent in June (Figure 8).

Net foreign asset position shrunk in June

The net foreign assets (NFAs) of the Saudi financial system slipped by 0.1 percent month-on-month, but remained 12.8 percent higher than in June 2012. Both SAMA and commercial banks recorded lower NFA in June compared with previous month.

SAMA's NFA slipped by SR2.6 billion in June as foreign assets declined by 0.1 percent month-on-month to SR2.5 trillion. Within foreign assets, SAMA deposits with banks abroad dropped by SR24.5 billion in June while investment in foreign securities and in foreign currencies convertible to gold increased by SR15.3 billion and SR6.2 billion in June, respectively. At the same time, SAMA's foreign liabilities decreased from SR5.7 billion at the end May to SR5.3 billion in June. While the reduction in gross foreign assets is not in line with the recent trend of higher oil exports and higher prices, it may reflect higher fiscal spending in the past month as the government maintains an expansionary fiscal policy. Lower foreign asset position also contributed to lower total assets in June, which slipped by 0.2 percent month-on-month to SR2,597 billion. As highlighted in our previous monetary updates, we maintain our view that the positive momentum in SAMA's foreign assets is likely to slow over the coming few months relative to their strong growth last year as oil prices shift to below \$105 per barrel (pb) and the Kingdom adjusts its production to an average of 9.6mbpd this year.

The NFAs of the commercial banks slightly declined in June to SR138.5 billion in June, or 0.5 percent lower than its level in May. This decline was mainly due to a 0.6 percent month-on-month decrease in gross foreign assets to SR214 billion while foreign liabilities eased by 0.7 percent. Despite the decline in foreign assets, bank foreign assets are 2.8 times the foreign liabilities reflecting the strong external position of the local banks. On their domestic position, banks remained liquid with elevated deposits at the central

Figure 2: NFA & NDA contribution to M3 growth

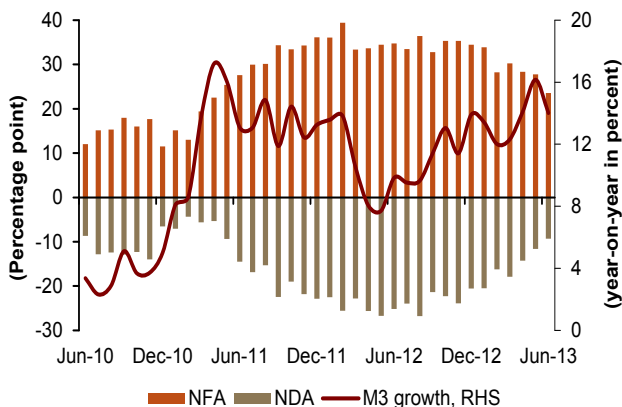
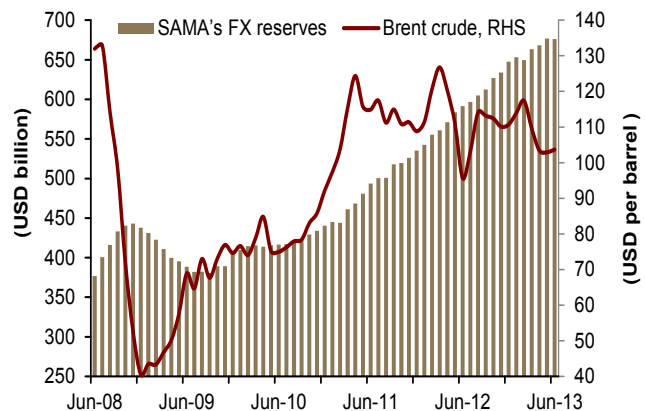


Figure 3: FX reserves and oil prices





Bank excess deposits with SAMA remained dropped in June but remained higher than a year ago.

Growth of bank credit to private sector slowed to 15.9 percent year-on-year in June.

We expect the positive credit momentum to remain given the supportive macroeconomic environment...

...with medium- and long-term credit taking the lead.

bank. While contracting by 14.3 percent month-on-month, these deposits were SR135.2 billion in June or 12 percent higher than a year ago. 41 percent of these deposits or SR56 billion are excess liquidity. This reflects the ample liquidity in the Saudi banking system which could translate into higher credit growth in the coming months.

Credit to private sector maintained a positive trend

Credit to the private sector (excluding securities lending) expanded 15.9 percent year-on-year (1.4 percent month-on-month) in June compared with 16.5 percent year-on-year (1.3 percent month-on-month) in May. In nominal terms, banks increased their credit portfolio by SR13.9 billion in June compared with SR12.8 billion the previous month. Loans, advances and overdrafts combined to make the largest contribution (15.7 percentage point) to the year-on-year credit growth in June. In addition, total claims on the private sector, which include investment in private securities, expanded 1.4 percent month-on-month in June leading to a year-on-year growth of 16 percent compared with 16.5 percent the previous month.

We expect growth in credit to the private sector to expand further this year (16 percent year-on-year), although with a smoother trajectory than we saw last year (16.4 percent year-on-year). On this basis, we expect the incremental increase in bank credit issued to the private sector to reach SR154 billion in 2013 compared with SR135.7 billion last year and close to an all-time high record of SR155.3 billion in 2008. Expansionary government fiscal policy and rising disposable income are expected to be the main growth driver, while regional geopolitical risk and external economic environment present a downside risk on general market sentiment, hence on credit growth. As we previously highlighted, credit with long-term maturity profiles will maintain a solid expiation on the back of higher government capital spending. Year-to-June, long-term credit expanded by 17 percent compared with a contraction of 4 percent for the same period last year. As a result, the share of long term credit to total credit improved to 28.5 percent in June compared with 24 percent a year earlier. Medium-term credit should also improve given the government's expansionary current expenditures, gains in Saudi public and private sector employment and the positive outlook for the housing market development. As such, medium term credit expanded by 21 percent year-on-year in June while its share of total bank credit improved from 17.8 percent in June 2012 to 18.6 percent in June 2013.

Figure 4: Bank holding of government securities

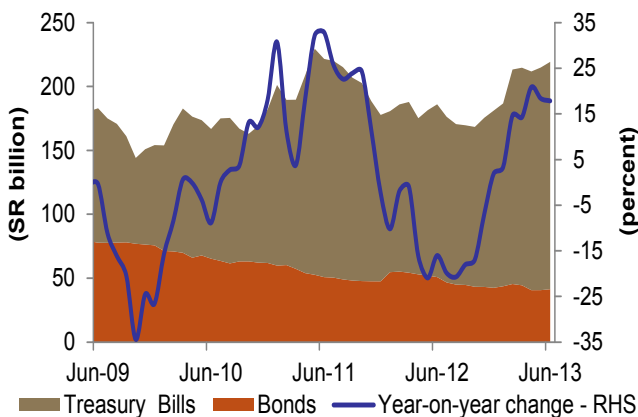
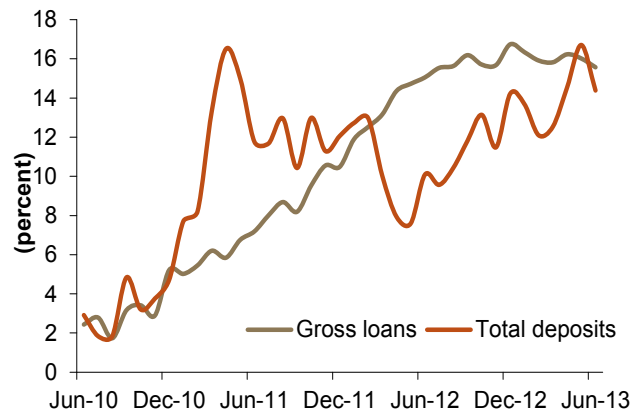


Figure 5: Bank deposits and loans (year-on-year change)





Bank claims on government continued to expand in June...

...as their holdings of treasury bills continue to increase.

Bank deposits slipped in June, but remained higher than a year ago.

Loan-to-deposit ration rose to 81.5 percent.

3 month Saibor maintained a downward trend since January's peak...

...but regional geopolitical risk could increase its volatility.

We maintain our view that bank profits are set to break an all-time record high this year.

Growth of bank claims on government remained positive in June owing to higher investment in treasury bills, while banks holding of development bonds trended slightly up. Commercial bank added SR3.7 billion to their treasury bills holding in June leading to a total holding of SR178 billion or 31.6 percent higher than a year earlier. We expect SAMA to gradually increase treasury bill issuance as government bonds mature and banks remain liquid. In fact, banks prefer to hold treasury bills which generate higher returns than their excess deposits at SAMA. Banks holding of development slightly increased by 1.8 percent month-on-month in June, but remained 18.6 percent lower than a year earlier.

Funding and liquidity profiles will support record profit

Bank deposits as a main source of bank funding in the Kingdom maintain a solid expansion with a double digit annual growth in the last two years and into this year. In June, however, the deposit growth slowed to 14.4 percent year-on-year (-0.3 percent month-on-month) from 16.7 percent year-on-year in May. In nominal terms, bank deposits slipped by SR3.6 billion in June with deposits in foreign currencies accounting for most of the contraction while demand and saving deposits maintained a positive growth. As monthly growth in credit to private sector and non-financial government entities remained positive (1.3 percent) in June while deposits contracted (-0.3 percent), the system-wide loan-to-deposit ratio increased from 80.3 percent in May to 81.5 percent in June, the highest level since February.

At the same time, three-month Saibor continued on a downward trend after the January peak of 0.9975 percent to 0.9613 percent on July 28. While the ample liquidity of the banking sector played a role on pushing the rate down, external political and economic environment is likely increase its volatility.

The expansion in credit and low funding costs continue to contribute to a pick-up in bank profits. In June, banks recorded a profit of SR3.3 billion, the highest monthly profit since January 2012, taking the year -to-June profit to SR17.7 billion. Based on an expected solid path for credit growth and low funding costs, we expect this year's bank profits to surpass the all-time high of SR34.7 billion recorded in 2006.

Figure 6: Composition of bank deposits

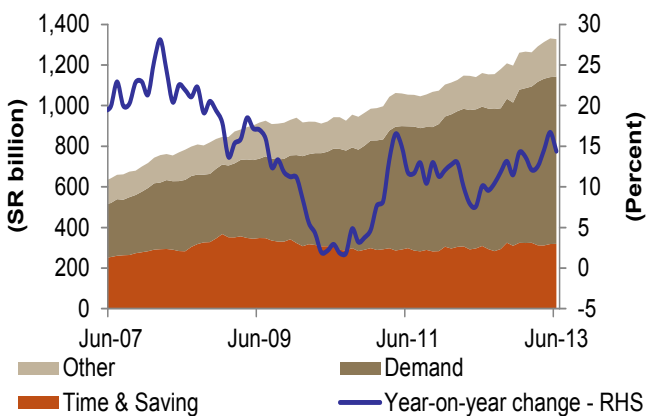


Figure 7: Bank profits

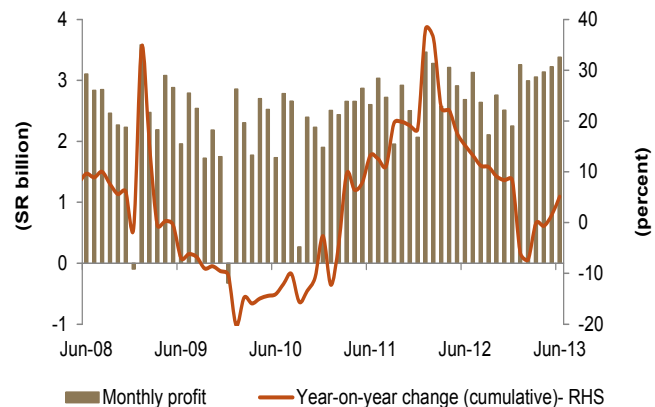




Figure 8: Annual growth of broad money supply slows but not money multiplier

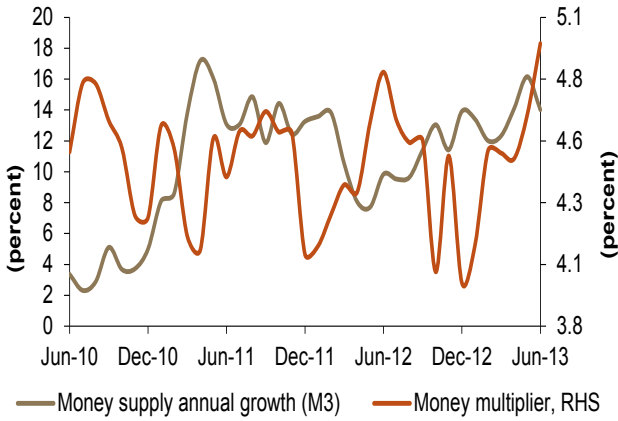


Figure 9: Long term lending remained the main driver of credit annual growth in June

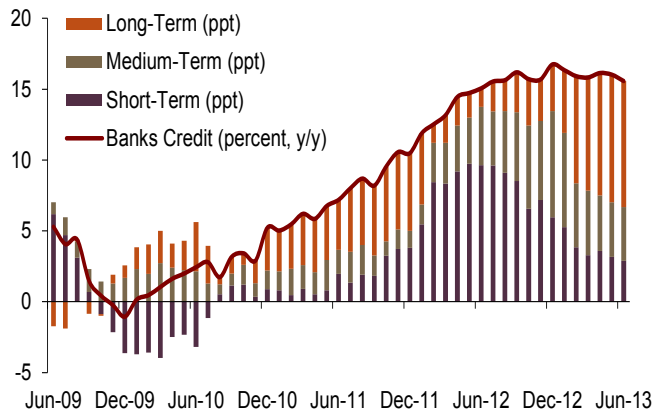


Figure 10: Bank excess reserves at SAMA shrunk in June

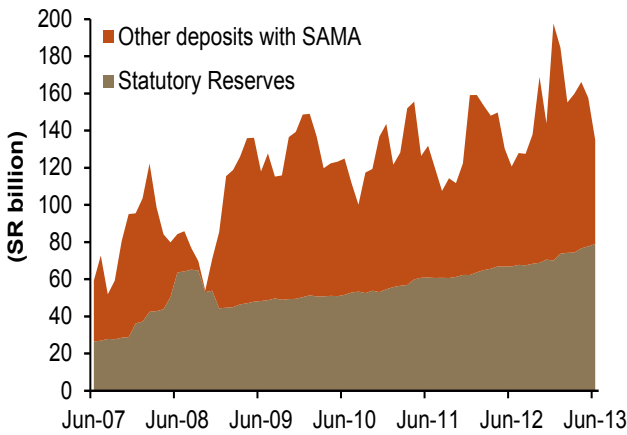


Figure 11: Loan-to-deposits ratio rose to 81.5 percent as credit grew further

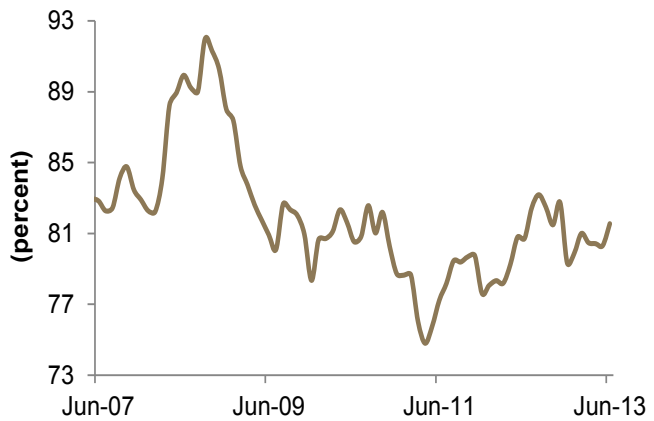


Figure 12: Policy interest rate is expected to remain on hold

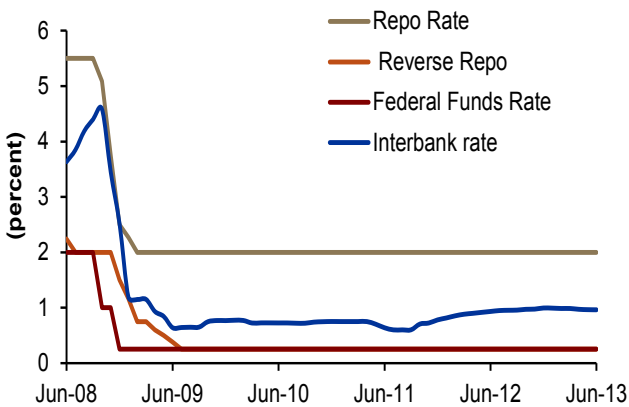
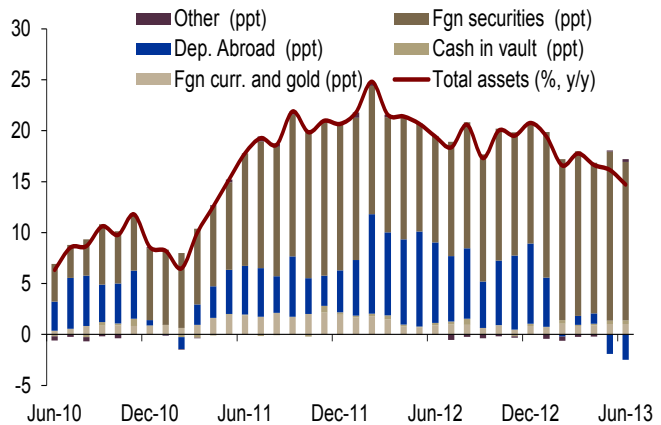


Figure 13: Shrinking deposits with banks abroad pushed SAMA's assets down





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