Monetary Watch

February 28, 2011

البنك السعودي الفرنسي
Banque Saudi Fransi

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Monthly Monetary Indicators

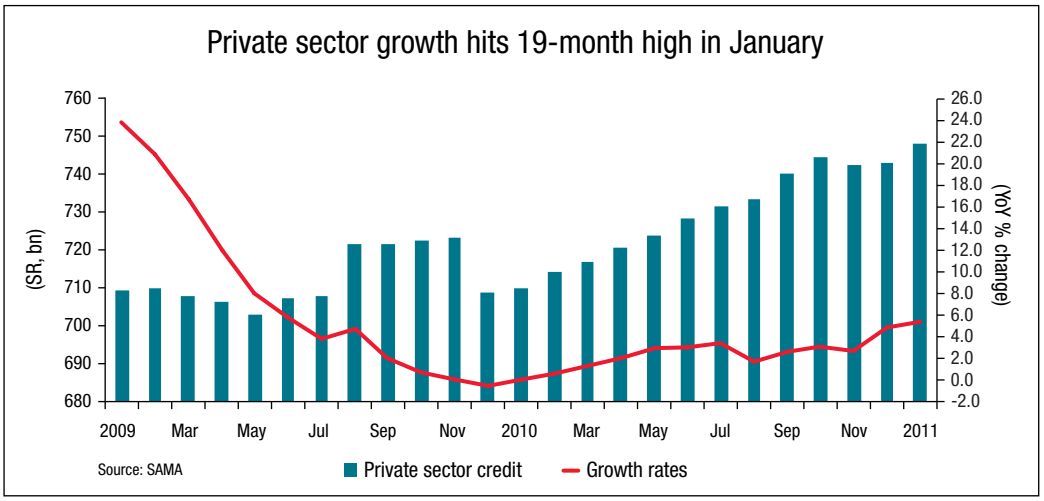
January loan growth gains, foreign assets at record as pressure looms

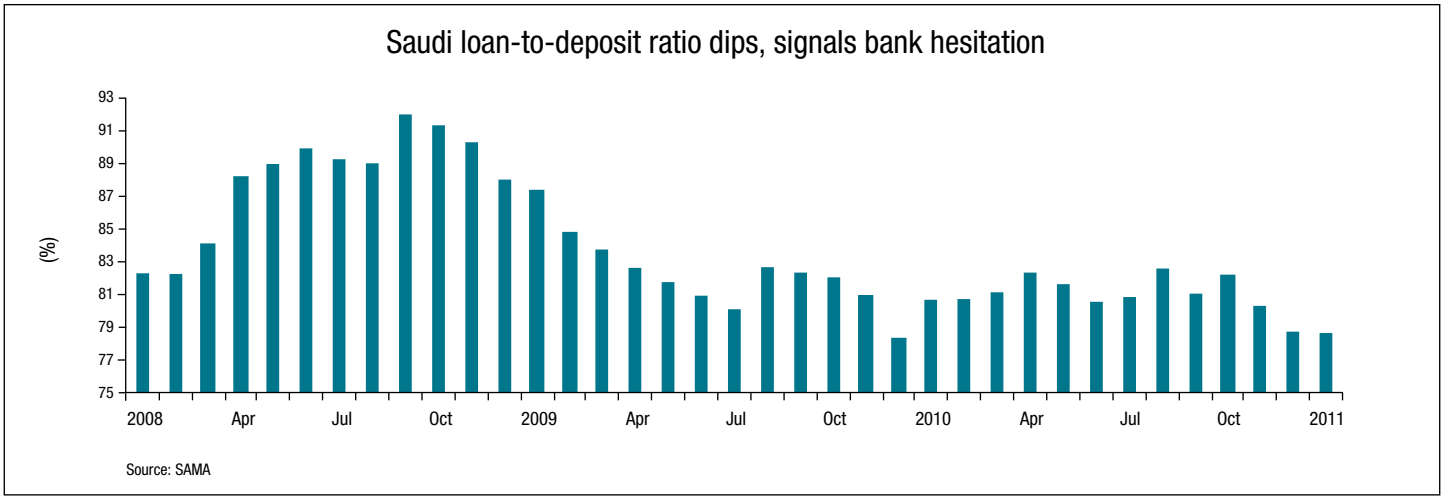
- **Private bank lending expands fastest in 19 months in January**
- **Foreign assets jump to record but government benefits scheme could weigh**
- **Money supply growth picks up, demand deposits continue ascent**
- **Banks still hesitant to lend, loan-to-deposit ratio falls to 78.6%**

Private sector loan growth hit a 19-month high above 5% in January, backing evidence that Saudi Arabia's economic recovery is picking up pace as private sector firms take on a larger role. Money supply growth also accelerated quickly for the fourth month, climbing to 8.1% for broad money (M3), the fastest advance in a year. Still, while strong oil prices lifted the kingdom's foreign assets to a record level in January, a sweeping SR135 billion state benefits scheme for citizens, unveiled this month, is likely to trim down this pace of growth as the year progresses. Regional turmoil could complicate the recovery process if private sector firms pull back.

Private bank credit, excluding investments in securities, rose to SR748.2 billion in January, up 5.4% year on year, and the highest rate of growth since June 2009, according to data of the Saudi Arabian Monetary Agency (SAMA). Lending was up 0.7% from December, and over all claims on the private sector advanced 6.3% in January to SR781.6 billion, the data show. Bank credit in Saudi Arabia has struggled to recuperate following a downturn subsequent to the onset of the global financial crisis, which slashed loan growth rates to a fifth of what they were. The recovery continues at a moderate pace as banks vet loan requests rigorously, and private sector investment appetite remains moderate.

This is evidenced in the loan-to-deposit ratio, which fell slightly to 78.6% in January, compared with higher than 80% in all but one month in 2010. In 2008, at the height of an economic boom, the loan-to-deposit ratio had surpassed 90% for a number of months. This shows that while banks are liquid– deposits continue to grow, their foreign asset holdings are climbing– they are still exceptionally hesitant to agree to new loans. Public sector credit growth, meanwhile, fell in January by 4%.





As we have argued in previous notes, long-term project financing deals are likely to catalyse Saudi Arabia's credit recovery in the coming two years. The proportion of loans outstanding in January carrying long-term maturities of three years or longer (classified as "long term") climbed to 25% from 24.8% the month earlier, data show. Meanwhile, the ratio of short-term loans (less than one year) to total loans fell to 58.6% in January, the lowest in more than two and a half years.

A loan renewal will rely on the continued interest and engagement of domestic and foreign private sector companies in the kingdom's recovery programme. The state has shouldered economic growth in the last two years; government sector GDP expanded more than 11%. It is still unclear how regional political turmoil in a number of Middle East countries will affect the investment decisions of private sector businesses in Saudi Arabia. The Saudi stock exchange has fallen almost 12% since Jan. 25, when Egypt's popular revolution kicked off. Numerous Saudi businesses invested in Egypt could suffer as a result of lower economic growth there, as well as equity market volatility. As of yet we are not revising our macro-economic forecasts, although downside risks will mount should confidence, investments and consumption decline.

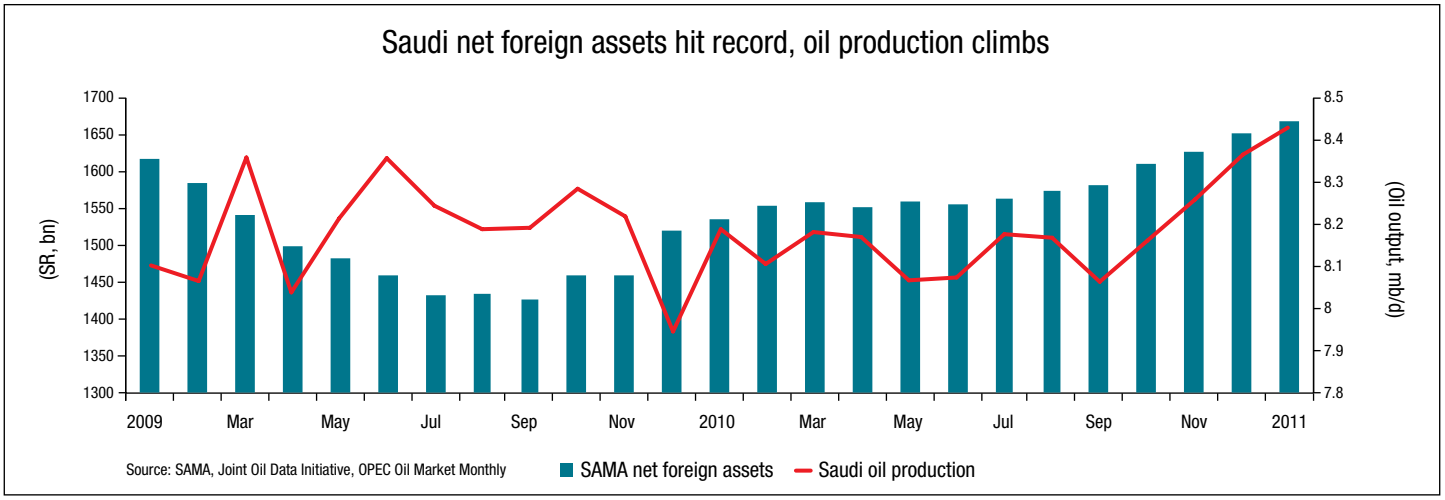
SAMA foreign assets hit record, growth could subside

The Saudi central bank's foreign assets stash also received a substantial boost of SR16.77 billion ($4.47 billion) in January due to elevated oil prices, which averaged $89.58 a barrel for the month. SAMA foreign assets stood at SR1.668 trillion ($444.8 billion), 8.7% more than a year earlier and the largest holding for SAMA on record. The holdings in January surpassed SAMA's previous record in November 2008, after which the country was forced to draw down its reserves to finance its budget during an oil price slump.

The state's investments in foreign securities – which comprise long-term, low-risk investments such as bonds – rose 10.9% in January while deposits with banks abroad slipped 0.4%, the slowest pace of growth since February 2010.

A word of caution on foreign assets: while oil prices promise to remain elevated due to regional turbulence, the government has also embarked on a SR135 billion citizen support package that aims to support nationals, including plans to provide jobless Saudis with an unemployment benefit for the first time. The finance minister has said this extra spending to cover this plan would come from state reserves. It is likely SAMA will draw down deposits with banks abroad in the coming months, which may reduce the central bank's overall foreign asset holdings or at least slow down growth.

We estimate about SR98 billion could be drawn down to support the programme, which pledged to expand public sector employment and made permanent a 15% cost of living increase introduced in the last three years. Our preliminary calculations show an additional cost of just SR45 million for the wage bill; costs related to the 130,000 permanent public sector employees were already accounted



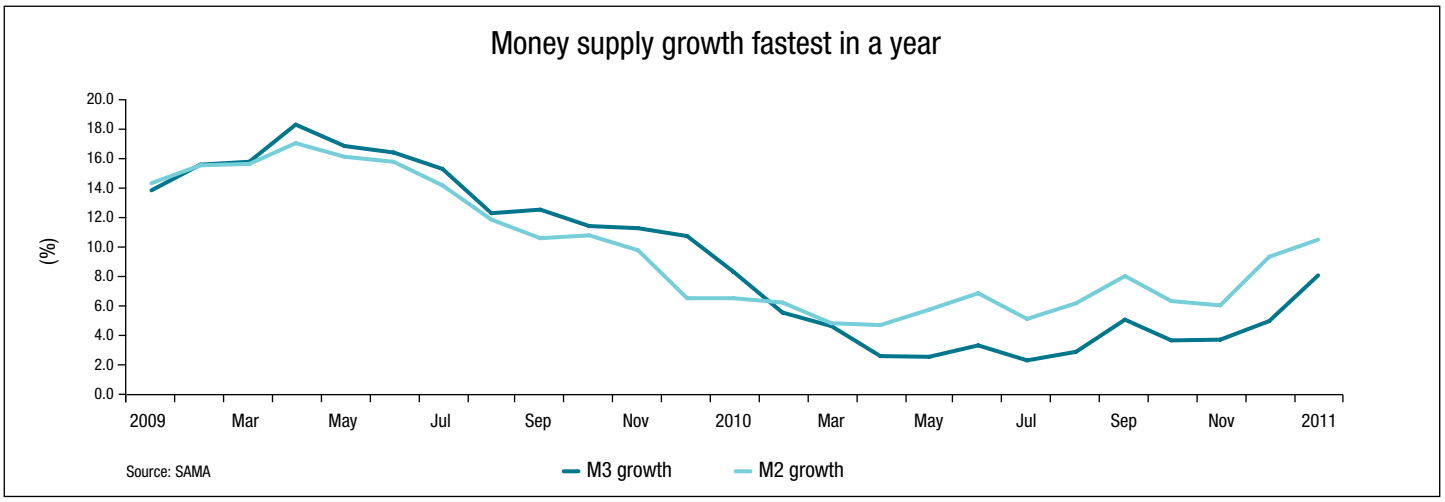
for in the budget. Longer term, pensions will exert greater pressure on the government in the coming decades. Expanding the public work force is a short-term solution that will fast long-term challenges.

However, Saudi Arabia has raised oil output to as much as 9 million barrels per day, compared with about 8.5 mbpd in January, in a bid to quell price pressures resulting from a decline in output from Libya, the third North African state facing a significant popular revolt following successful revolutions in Tunisia and Egypt. As regional political turmoil continues to unfold, we are reviewing our oil market forecasts, which initially foresaw Saudi crude oil production of 8.48 mbpd in 2011 and an average WTI oil price of $82.50 a barrel. The extra production and higher prices – $89.8/barrel average price for U.S. oil and $103.7/barrel for Brent crude in February – will nonetheless offset a good deal of the burden of any additional budgetary spending this year by the government.

Money supply, deposits growth strengthen

Both money supply and deposit growth painted an optimistic picture in January. Growth in M3 of 8.1% in January compared with 5% in December and below 3% in each of October and November. M2 – which includes demand deposits, currency outside banks and time & savings deposits – topped 10% for the first time since October 2009.

The kingdom's monetary base, comprising highly liquid currency in banks and held by the public, rose fell 5.6% year on year and



7.5% month on month in January to SR235.73 billion, data show. This likely indicates that additional capital is being deployed in the economy rather than held in bank coffers. The money multiplier, rose for the first time after dropping for five months straight. The multiplier climbed to 4.61 from 4.24 in December.

A 7.7% gain in deposits to SR987.92 billion was due to continued preference for demand deposits as well as a small spike in foreign currency deposits, data show. Non-interest bearing demand deposits comprise almost 55% of total Saudi deposits – up almost 13 basis points in the past two years. This shift has been supported by a low interest rate environment reducing the appeal of interest-bearing time and savings deposits. Funds held in this category of deposits fell 6.1% in January, while foreign currency deposits were down 6.9% year on year in January, although they gained 6.3% from the month earlier.

These ratios are likely to hold this year as the central bank appears poised to hold interest rates at current levels in a bid to encourage greater bank lending. We anticipate a change in the benchmark rate only next year.

Point-of-sale transactions also reflected the general pick up in economic activity, rising 28.2% year on year to SR6.51 billion – a 2.9% advance from December. The value of commercial and personal cheques also rose 14.6% in January to SR47.7 billion. Since Saudi Arabia is still an overwhelmingly cash-based society, these data are not completely reliable in offering a picture on the economic condition. However, they do point to the consistent upturn in private consumption, which is supported by anecdotal evidence. Saudi inflation fell to 5.3% in January, having declined gradually from an 18-month high of 6.1% in August. As global food prices continuously climb, the government is likely to keep a close eye on food and housing prices this year.

On the trade front, letters of credit were little changed in January– new LCs issued against imports were up just 1.5% year on year in January. The level of LCs issued tends to vary widely depending on the month of the year. We expect import flows to improve in 2011 after rising less than 1% last year.

The general economic pick up will, however, continue to depend on the attitude of banks. Another signal of banks' continued hesitation is their holdings in foreign assets, which jumped almost 23% in the year to January, including a 6% rise from December. Still, banks drew down funds held in the central bank's repo window by 32.5%, the seventh straight month of declines. We expect banks will strive to step up lending this year to help improve profits following a few years of weak performance.

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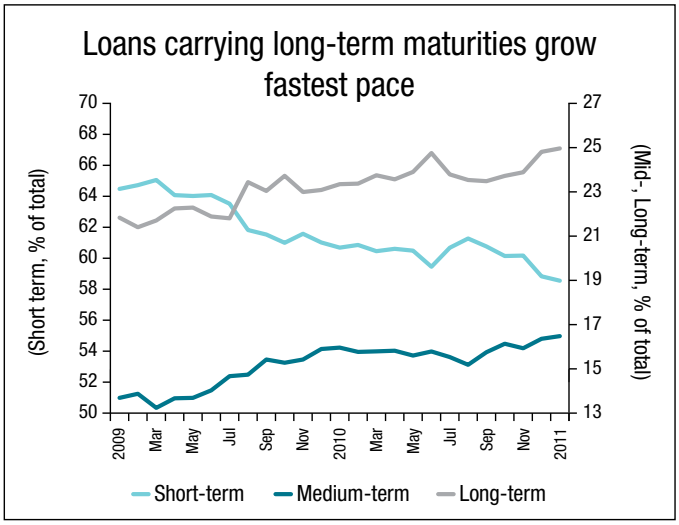

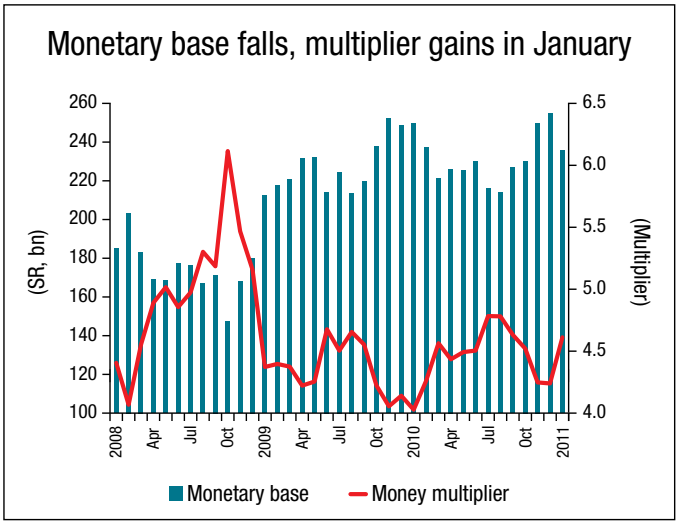

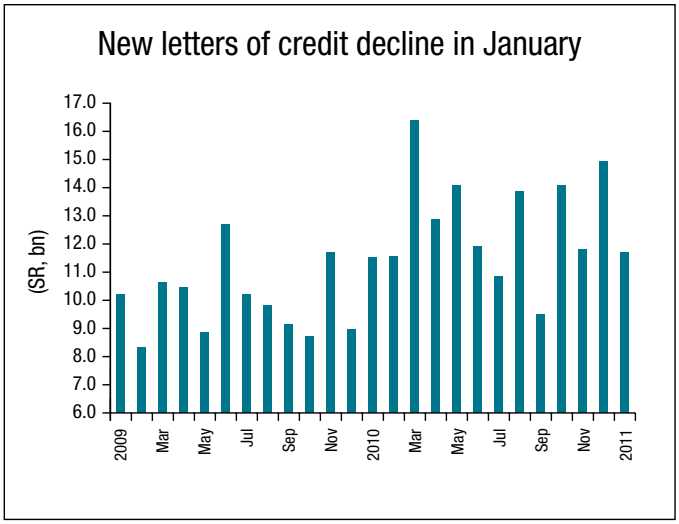

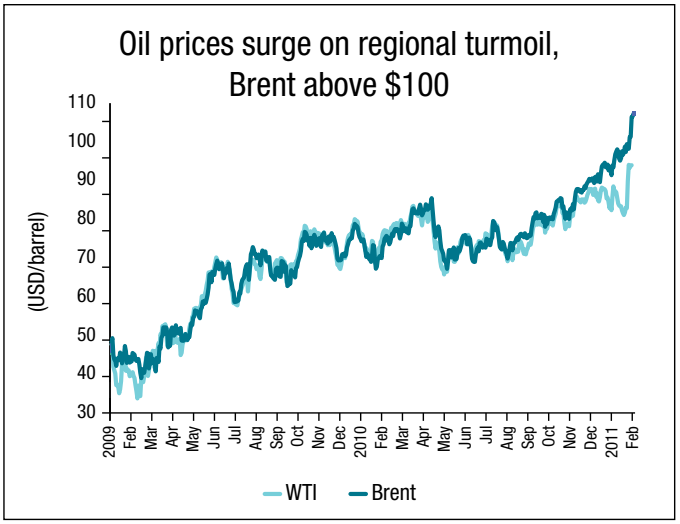

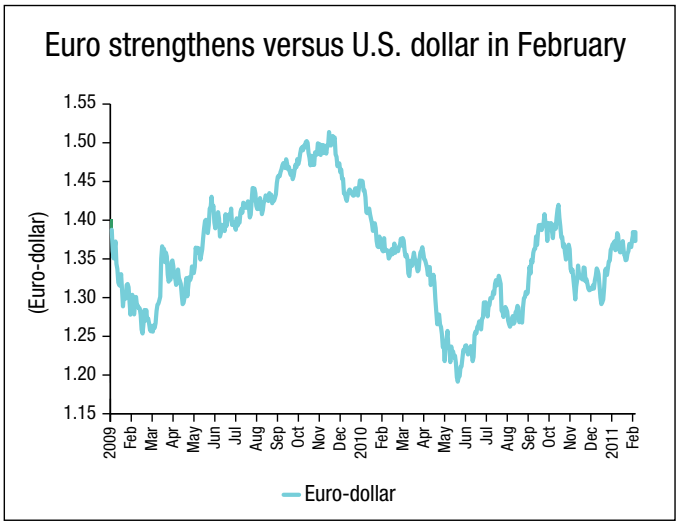

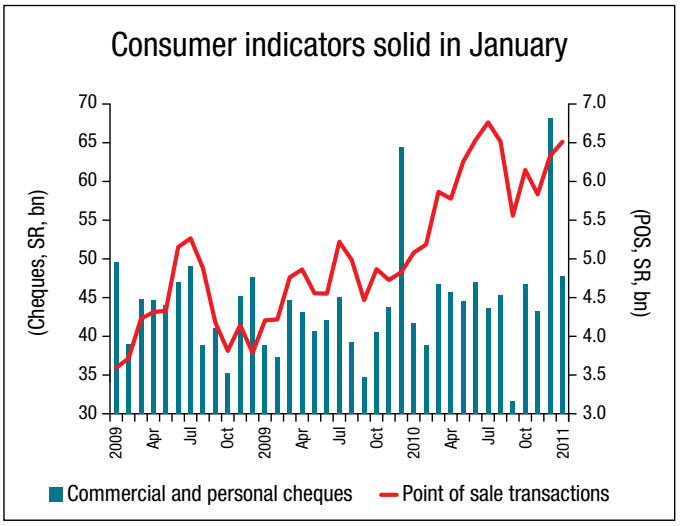

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