



مجلس الأعمال السعودي الأمريكي
U.S.-Saudi Arabian Business Council

Industry Trends: Saudi Arabian Banking

May 2018

The strong capital adequacy ratio of Saudi Arabia's banking system, bolstered consumer confidence, and rising deposits in 2018 will support a rise in assets and overall stability of the Kingdom's banking sector over the coming year. Amid past declines in oil prices, deposit growth has slowed over 2016 and 2017; however, banks have increased capital and reserves from 13.5 percent to 15.7 percent of total liabilities in 2017, compensating for slow deposit growth.

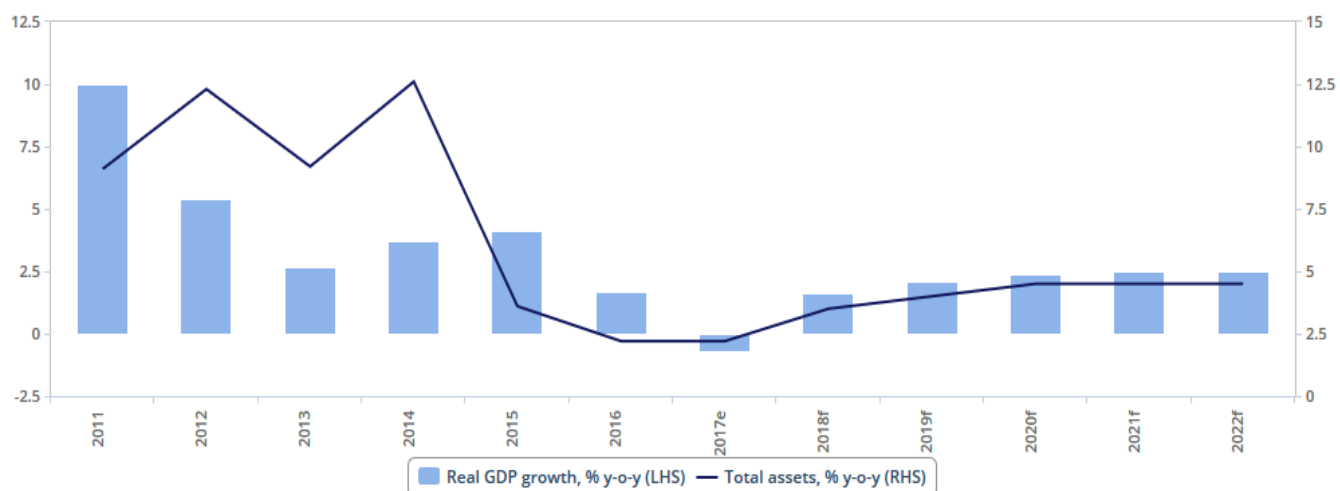
Amid the reforms taking place as part of Vision 2030, a number of foreign banks have also taken notice, either securing new licenses to operate in the Kingdom or making plans to expand existing operations. According to the Saudi Arabian Monetary Authority (SAMA), the country received several new foreign license requests in 2017 and has 14 foreign bank branches in operation.

Both the Saudi Government and the private sector are expected to drive expansion of assets over the next several years. While the Kingdom's public finances suffered from stumbling oil prices in 2014, the country's financial landscape has weathered this storm. At the end of 2017, Saudi Arabia's foreign reserves were \$497 billion. (This is approximately equivalent to 30 months of import cover, whereas 3 months of import cover is deemed adequate by international standards). Economists suggest that the strong financial positioning of the Saudi Government mitigates risk in the banking sector in the event of potential external shocks. BMI Research forecasts show that assets will advance by 3.5 percent in 2018 and by 4.0 percent in 2019. The graph below shows the y-o-y growth trend of total assets and of real GDP.



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Saudi Arabian Banking Sector – Total Asset Growth and Real GDP Growth Percentage Growth Data and Forecasts (2011-2022)



Source: The Council, BMI Research, SAMA

Notes: Total assets are analogous to the combined balance sheet assets of all commercial banks in a particular country. They do not incorporate the balance sheet of the central bank of the country in question. In aggregate, it is the sum of 'client loans', 'bond portfolio' and 'other assets'.

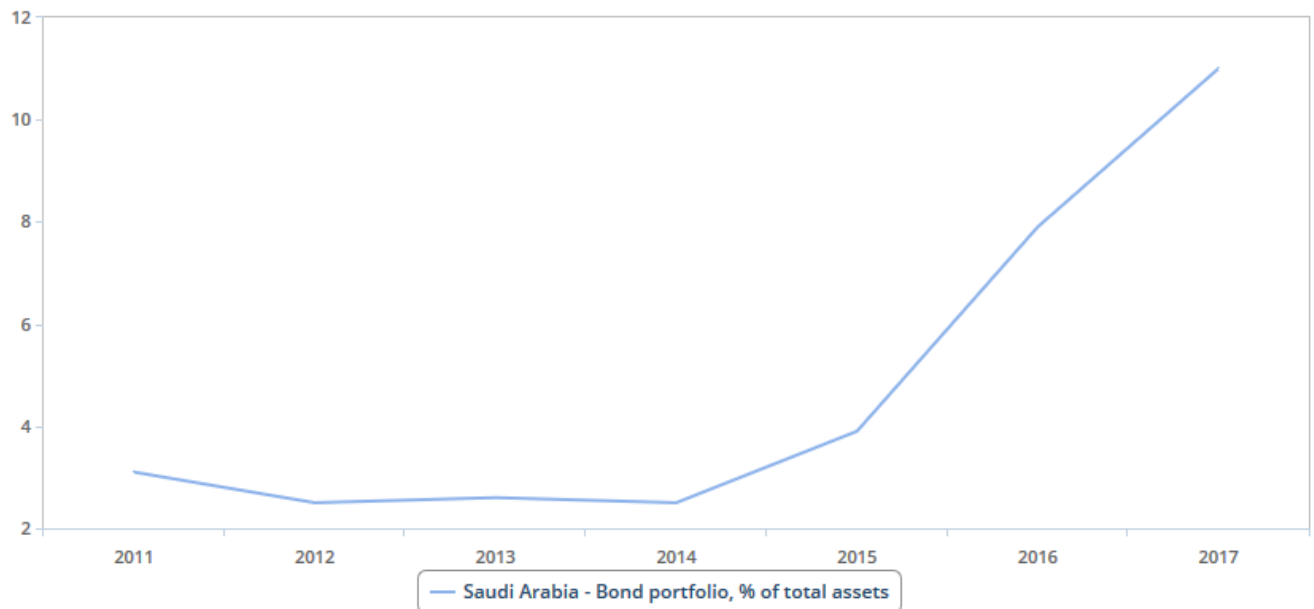
The outlook for the country's asset quality also remains strong. The Kingdom's non-performing loans (NPL) ratio was 1.6 percent in 2017, one of the lowest regionally and very low by global comparison. Banks have also taken recent actions to protect against bad debt.

Saudi Arabia's bond portfolio reached 11 percent of total assets in 2017. As shown below, the rising percentage of bonds, particularly in the past two years, reflects the emergence of debt issuances in 2016 as a key source of financing. Saudi Arabia's bond portfolio grew from 3.9 percent of total assets in 2015 to 7.9 percent of total assets in 2016, and this tends to be a relatively safe source of asset growth in comparison with loans.



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Saudi Arabian Bond Portfolio Trend Percentage of Total Assets Data (2011-2017)



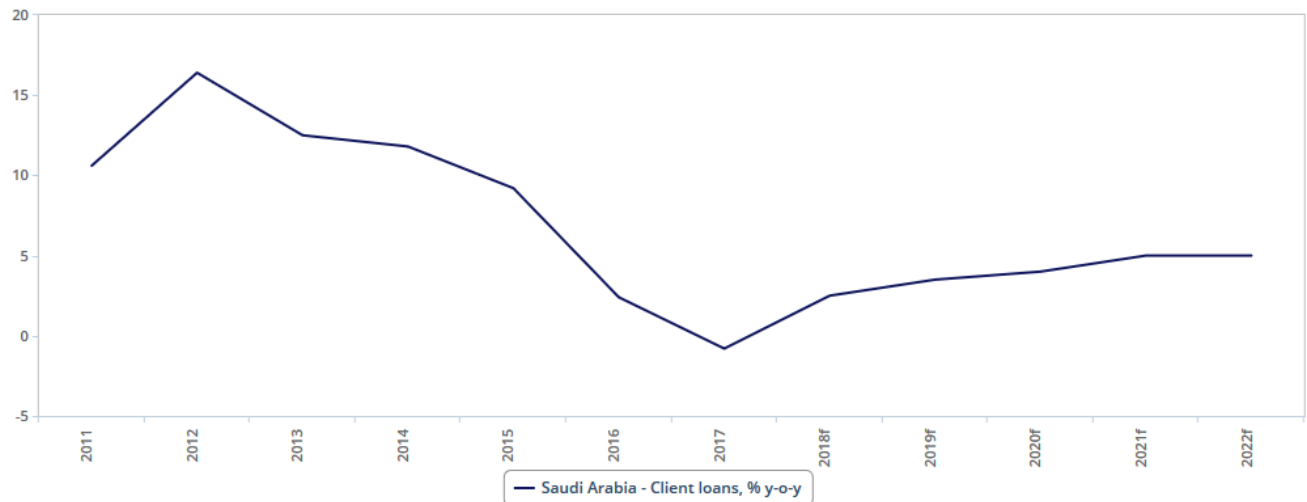
Source: The Council, BMI Research, SAMA

A robust strengthening of the macroeconomic environment in the Kingdom will also support the stability of the country's financial sector in coming years. Largely, rising oil prices tend to boost consumer confidence, and this stronger confidence leads businesses to expand and also encourages consumers to take out more credit. We expect that rising oil prices in 2018 will drive an increase in client loans through 2022. The below chart displays the year-on-year growth in client loans, including those to the private sector, public sector, and state enterprises.



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Saudi Arabian Banking Sector – Client Loans Growth Percentage Growth Data and Forecasts (2011-2022)



Source: The Council, BMI Research, SAMA

Notes: Client loans are loans to non-bank clients. They include loans to private sector, public sector and state-owned enterprises. However, they generally do not include loans to governments, government (or non-government) bonds held or loans to central banks.

Loans to clients will become increasingly available as the financial outlook of the banking sector continues to improve.

Amid declining oil prices, Saudi Arabia closed a \$10 billion syndicated loan in 2016, which it refinanced to \$16 billion in 2018. Following the first loan deal, the country issued \$17.5 billion in international bonds, the largest amount ever issued by an emerging market. In 2017, the country further issued \$9 billion worth of sukuk and made a \$12.5 billion conventional bond issuance. Reportedly, Saudi Arabia will borrow more funds from international debt capital markets in the second half of 2018, suggesting another multi-billion dollar issuance in the coming months.



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Saudi Arabia's debt sales have improved the adequacy of the country's capital following the liquidity squeeze after falling oil prices in 2014. Companies have been able to resume work on megaprojects through new bank loans that allow them to pay outstanding debt to workers.

According to the International Monetary Fund's *Financial System Stability Assessment* for Saudi Arabia – in coordination with the Saudi Arabian Monetary Authority (SAMA) – all Saudi Banks have a capital adequacy ratio (CAR) that exceeds minimum requirements. The CAR level suggests that the overall banking system is resilient to severe shocks such as sluggish oil prices in the future. As of 2017, Saudi banks had a tier 1 CAR of 18.3 percent, comfortably above the 10.5 percent requirement.

The Saudi banking system currently has limited exposure to foreign currency risks. In 2017, foreign assets accounted for 4.1 percent of total liabilities. Given the picture of slow asset growth, banks may try to boost growth through other avenues – and this could potentially mean increasing FX exposure.

For Q1 2018, the Saudi Arabian banking sector showed robustness with cumulative reported net profits rising by 18 percent q-o-q and rising by 7.5 percent y-o-y. Meanwhile, interest expenses of the Kingdom's banks decreased by 12.5 percent y-o-y. A recent report by Moody's Investors Services noted, *"The results are credit positive for Saudi banks because the improvement occurred amid subdued economic activity that negatively affected credit demand and banks' revenue."* Further, Moody's commented *"Saudi Arabia's improving liquidity and funding conditions since 2017 have narrowed the Saudi Arabian Interbank Offered Rate's (SAIBOR) spread against the US dollar-denominated London Interbank Offered Rate, even reaching negative spreads in March 2018, despite a number of rate hikes by the US Federal Reserve."*

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