جدوى للإستثمار
Jadwa Investment

January 2019

Monetary and Financial Update

Gradual Pickup in Private Sector Lending

Key Indicators
Percent, year-to-November

Indicator	Year-to-November 2017	Year-to-November 2018
M3	-1	0.7
Credit to private sector	0.5	3.7
Claims on public sector	22.7	16
Private deposits	-2.3	1.7
Loan-to-deposit ratio*	81.8	79.2

**Period average*

- **Monetary Policy - Global:** The US Federal Reserve (Fed) raised the Federal Fund Rate (FFR) in December, and lowered its projections from three to two hikes in 2019. The latest survey data show that the market expects no further hikes in 2019. Therefore, we see a rising level of uncertainty in the Fed's rate decisions in 2019, with a downside projection, as the Fed's latest statement acknowledged the slowing in global growth.

- **Monetary Policy - Domestic:** Accordingly**,** we expect to see the Saudi Arabian Monetary Authority (SAMA) following the Fed's decision, with a maximum of two rises during 2019, down from an expectation of three. If the Fed decides to go with its plan of two hikes in 2019, we could see the repo rate at 3.5 percent, and the reverse repo at 3 percent, by the end of 2019.

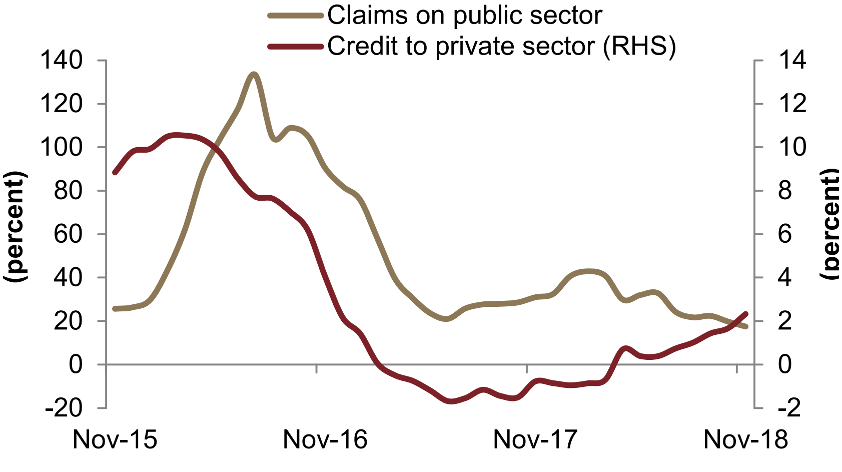
- **Money Supply:** In the year-to-November, M3 was marginally up by 0.7 percent. Excess liquidity in the banking system was almost flat during the last three months, which, in turn, led to a pickup in SAIBOR.

- **Claims on the Public Sector:** Lifted by government bonds, bank claims on the public sector rose by 16 percent year-to-November. However, the rise came lower than its pace in 2017 when it increased by 31 percent for the same period.

- **Claims on the Private Sector:** In the year-to-November, bank claims on the private sector rose by 4 percent, supported by an increase in credit to the private sector, which was up 3.7 percent, compared to 0.5 percent for the same period last year. Since April 2018, the annual growth in credit to the private sector has moved back into the positive territory.

- **Looking forward,** we see a number of elements weighing on private sector credit activity, such as VAT and the continuous reforms in the labor market. However, we believe that the record government spending stated in the 2019 fiscal budget of SR1.1 trillion will positively impact credit to the private sector and bank deposits as well.

Figure 1: Total Bank Claims
(year-on-year change)



For comments and queries please contact:

Fahad Alturki
Chief Economist & Head of Research
falturki@jadwa.com

Nouf N. Alsharif
Economist
nalsharif@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

Released: January-08-2019, 17:30 UTC+3

Global Monetary Outlook

The Fed lowered its own projections for 2019 from three to two hikes.

During 2018, the Fed raised the FFR four times; in March, June, September, and lastly in December by 25 bps on each occasion. As the FFR reached a range between 2.25 percent to 2.5 percent, the latest hike marks the ninth rate increase since December 2015. The Fed's latest statement acknowledged the slowing in global growth and tighter financial conditions, and lowered its own projections for 2019 from three to two hikes. That said, latest survey data from Reuters and Bloomberg show that the market expects no further hikes in 2019, with some even expecting a decline in US interest rates, rather than three hikes as previously anticipated (Figure 2).

We see a rising level of uncertainty regarding the Fed's interest rate decisions in 2019.

Therefore, we see a rising level of uncertainty regarding the Fed's interest rate decisions in 2019, with a downside projection. As such, we expect to see a slower pace of interest rate hikes, as the Fed's median projections for growth and inflation were revised down as well. However, the Fed has left the door open for any changes that could come up during the year.

The ECB went ahead with its plan with ending QE by December 2018, despite recent data confirming slowing EU growth.

Within the European Union (EU), the European Central Bank (ECB) went ahead with its plan with ending quantitative easing by December 2018, despite recent data confirming slowing EU growth in Q3, and German GDP contracting for the first time in 3 years (Figure 3). In its latest December meeting, the ECB acknowledged that the global economy is set to slow down in 2019 and stabilize thereafter. At the same time, the ECB is expecting some inflationary pressures within the EU during the year, which raises the possibility of a rate hike during the second half of 2019.

In the case of "no deal Brexit", the BoE is expected to cut interest rates and might initiate a new QE program to support the economy.

In the UK, as Brexit uncertainty hangs over the economy, the Bank of England (BoE) kept interest rates unchanged during its latest meeting in December, despite the improving GDP growth figures for Q3. With Brexit deadline approaching in March 2019, the UK Parliament needs to finalize a deal with the EU over trade, amongst other things. In the case of "no deal Brexit", the BoE is expected to cut interest rates and might also initiate a new quantitative easing program to support the economy. However, latest data shows wages growing higher than the BoE's forecast, despite a slowdown in inflation, which was likely affected by the easing energy prices.

Emerging markets are expected to be highly affected by the anticipated global slowdown, through lower volumes of trade and international investments. For example, the IMF has recently cut

Figure 2: Probability of US interest rate rises
(survey of expected rise in FFR in basis points by date)

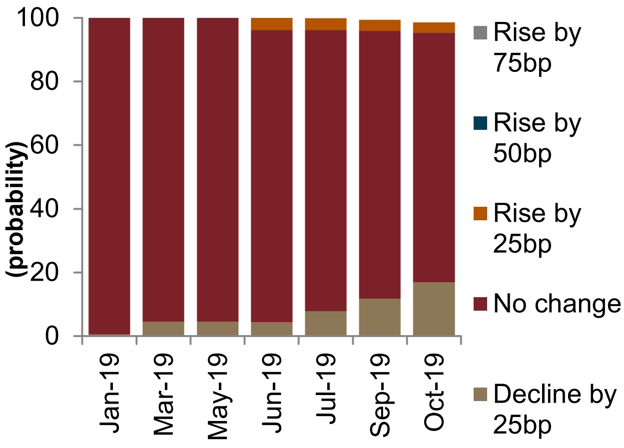
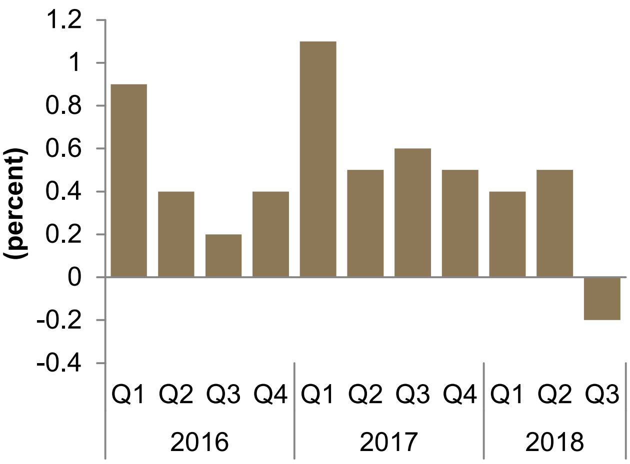


Figure 3: Germany GDP Growth Rate, Quarterly
(year-on-year)



The IMF has recently cut growth forecasts for China in 2019 from 6.4 to 6.2 percent.

growth forecasts for China in 2019 from 6.4 to 6.2 percent, as slowing global demand and higher US duties on Chinese goods would have a negative impact on the country's exports.

Saudi Monetary and Financial Outlook

We expect to see SAMA following the Fed's decision, with a maximum of two rises during 2019.

Since the beginning of the year, the Saudi Arabian Monetary Authority (SAMA) has increased the reverse repo and repo rates by 25 basis points (bps) four times, in March, June, September and December 2018 (Figure 4). The rises came in-line with the US Fed's interest rates hikes in 2018. However, as the Fed lately lowered its own projections for the year from three to two, we see a rising level of uncertainty regarding the Fed's interest rate decisions in 2019, with a downside projection. Therefore, we expect to see SAMA following the Fed's decision, with a maximum of two rises during 2019, down from an expectation of three. Accordingly, if the Fed decides to go with its plan of two hikes during the year, SAMA's repo rate could reach 3.5 percent, and the reverse repo could reach 3 percent, by the end of 2019.

Money supply, liquidity and deposits

In the year-to-November, M3 was marginally up by 0.7 percent.

In the year-to-November, the broad measure of money supply (M3) was marginally up by 0.7 percent. Out of all the money supply aggregates, (M1, M2, M3), M1 showed the highest rise year-to-November, boosted by a rise in currency in circulation, which rose by 4.5 percent (Figure 5). Excess liquidity in the banking system was almost flat during the last three months, which, in turn, led to a pickup in SAIBOR.

Total time deposits have followed a downward trend since October 2017, declining by 6 percent year-to-November.

Looking at the distribution of time deposits vs. demand deposits, we find that total time deposits have followed a downward trend since October 2017, declining by 6 percent year-to-November. This trend is largely due to the declining government time deposits (43 percent of total time deposits), which dropped by 16 percent, whilst private time deposits rose by 3 percent, in the year-to-November (Figure 6). Meanwhile, demand deposits rose by 2.6 percent year-to-November, supported by a rise in private demand deposits by 1.7 percent during the same period.

Bank claims

Total bank claims rose by 6 percent year-to-November, supported by a rise in claims to the public sector, up 16 percent year-to-November,

Figure 4: Market Rates in Saudi Arabia

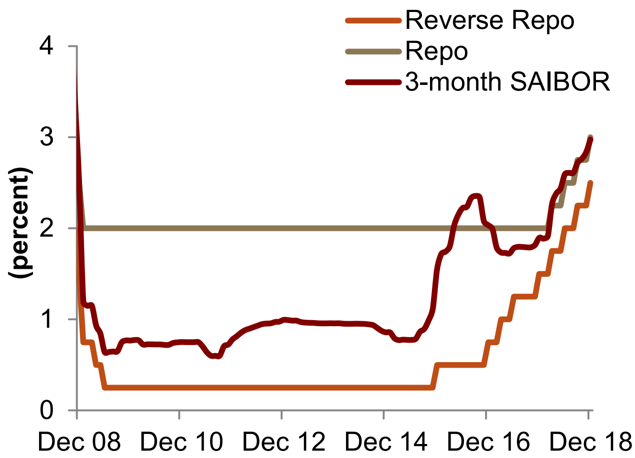
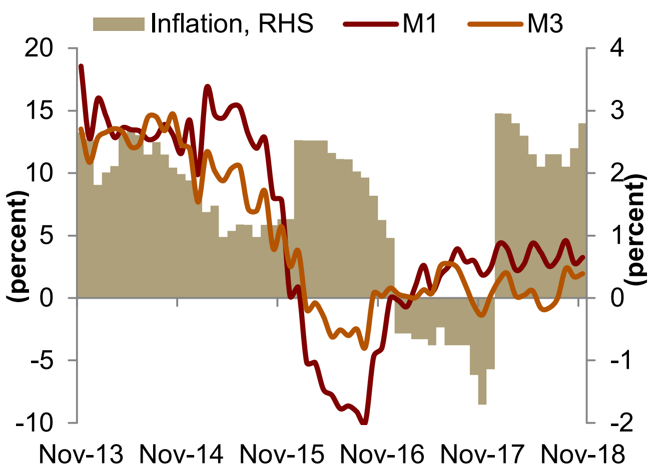


Figure 5: Money Supply
(year-on-year change)



The rise in claims on the public sector was lower than the pace in 2017.

equal to 20 percent of total bank claims. Government bonds showed the highest rise in claims to the public sector, by 19 percent year-to-November. That said, the rise in claims on the public sector was lower than the pace in 2017, when it increased by 31 percent during the same period (Figure 7).

Since April 2018, the annual growth in credit to the private sector has moved back into the positive territory, after showing a slowdown in 2017 and Q1 2018.

At the same time, bank claims on the private sector (81 percent of total bank claims) rose by 4 percent year-to-November, supported by an increase in credit to the private sector, which was up 3.7 percent year-to-November, compared to 0.5 percent for the same period last year. Since April 2018, the annual growth in credit to the private sector has moved back into the positive territory, after showing a slowdown in 2017 and Q1 2018. The recent improvement in credit to the private sector has likely resulted in an increase in loan-to-deposit ratio, up to 79.2 percent in November, well below SAMA's regulatory limit of 90 percent.

By credit maturity, long-term (including medium-term) credit rose by 5 percent year-to-November, whilst short-term credit rose only by 2 percent for the same period. Usually, long-term credit is considered as a significant indicator for corporate and business lending, which could indicate that the private sector is witnessing a pickup in activity in recent months (Figure 8).

New Letters of Credit

New LCs by commercial banks to the private sector enterprises declined by 11 percent in the year-to-November 2018.

New letters of credit (LCs) by commercial banks to the private sector enterprises declined by 11 percent in the year-to-November 2018, compared to the same period last year. Generally, all sectors saw a lower number of LCs in 2018, excluding the building materials, where LCs rose by 3 percent (Figure 9).

During 2018, most sectors witnessed a decline in the number of new LCs, as wholesale and retail sectors were affected by the implementation of VAT since January 2018, which likely altered their import activities in an attempt to reduce costs. In addition, with the implementation of VAT and expat levies, the private sector was preparing for lower local consumption coming from higher prices after the VAT, and less number of consumers driven by the increasing number of expats leaving the Kingdom as a result of the labor market reforms.

Looking forward, we see a number of elements weighing on credit to the private sector, affected by a structural reform taking place in

Figure 6: Breakdown of Government Deposits
(year-on-year change)

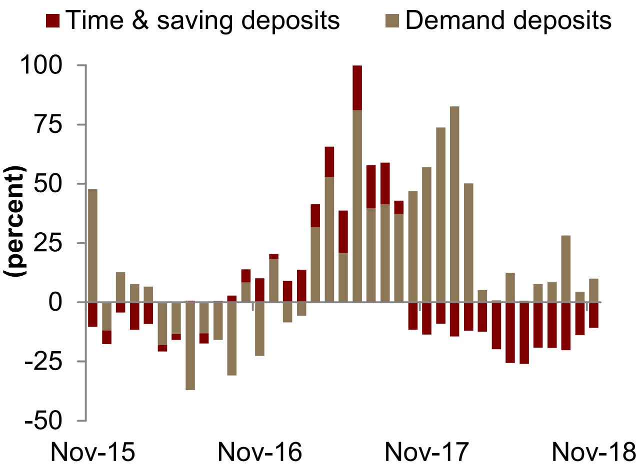
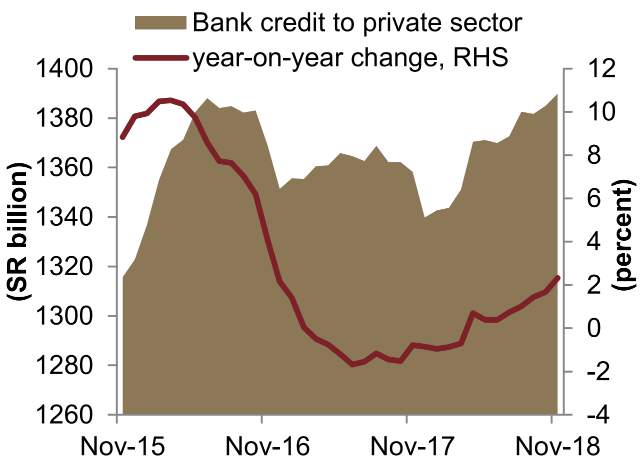


Figure 7: Bank Credit to the Private Sector
(year-on-year change)



Looking forward, we see a number of elements weighing on credit to the private sector.

Labor market reforms and VAT are expected to continue affecting the wholesale and retail sector activities.

Higher government spending in the 2019 budget, reaching SR1.1 trillion is expected to positively impact credit to the private sector and bank deposits as well.

the wholesale and retail sector, which occupies the largest share of credit to the private sector (20 percent of total credit to the private sector), and likely to weigh on its financial activities. Firstly, we expect consumer spending to be affected by the departure of expats, as the total number of foreigners in the Saudi labor market has declined by around 1.1 million since the start of 2017 up to the end of Q2 2018 (Figure 10). Added to that, the new Saudization wave in a number of retail sectors would likely lead to more expat departures. (Please see our latest [Labor Market Update Q2 2018]). As a result, latest GDP figures show that the wholesale and retail sector saw an average of a flat performance in the year-to-September of 2018. In 2019, the wholesale and retail sector is also likely to be affected by the reduction in VAT threshold starting Q1 2019, from a turnover of SR1 million in 2018, down to SR375 thousand in January 2019. This step should have added additional 300 thousand small and medium enterprises, with many of them in the wholesale and retail sector.

At the same time, we expect to see a pickup in bank credit to a number of other sectors, such as non-oil manufacturing and non-oil mining, as the latest GDP figures show an increase by an average of 5 and 3 percent in the two sectors year-to-September, respectively (Figure 11). In addition, higher government spending stated in the 2019 largest ever fiscal budget to reach SR1.1 trillion is expected to positively impact credit to the private sector and bank deposits as well.

Figure 8: Bank Credit by Maturity
(month-on-month change)

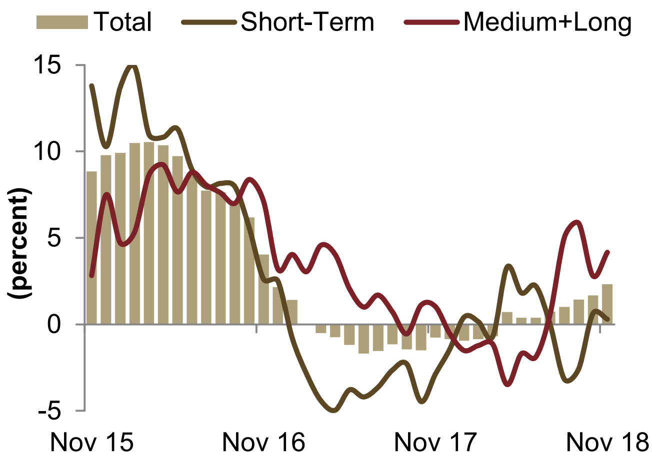


Figure 9: New LCs by the Private Sector
(year-to-November total)

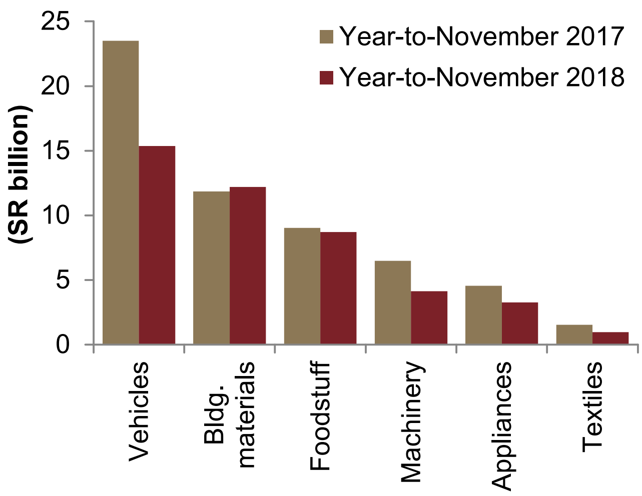


Figure 10: Number of Expats in the Labor Market

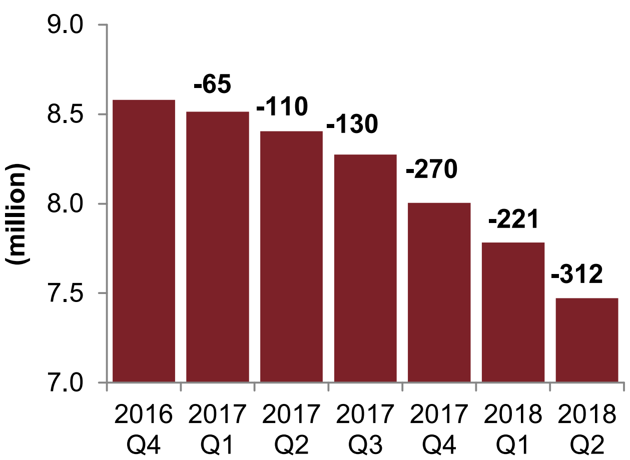
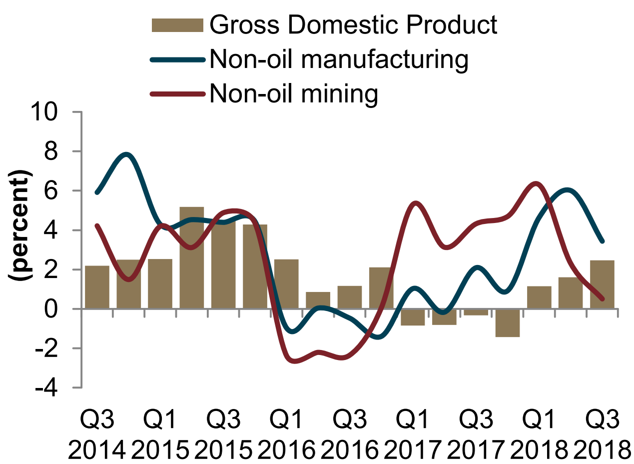


Figure 11: Growth rates



Disclaimer of Liability