

Saudi banks show resilience despite tough economic conditions

The Saudi banking system is confirming its reputation as one of the most resilient in the Middle East. Three years of low oil prices have certainly had an impact, but Saudi banks remain well capitalised and liquidity is starting to improve.

Arab Banker's Editor, Andrew Cunningham, reviews recent developments in the Saudi banking system.

2016 was a difficult year for Saudi banks. It began with oil prices falling below \$30/b for the first time in ten years, and continued with rating agency Standard & Poor's downgrading the Kingdom by two notches to A-, the same as Malaysia and Mexico. Government spending tightened and payments were delayed.

There was a clear impact on banks' performance. Eight out of the 12 domestic banks declared lower net profits than in 2015, and ten recorded lower returns on assets. (National Commercial Bank and Al-Rajhi were the two that showed higher returns.) Loan loss provisions increased by 50% across the banking system as a whole and provisions against investment losses more than doubled.

Yet conditions had already begun to improve in the final months of 2016. Banks breathed a huge sigh of relief in September when the government announced that public sector entities, such as the Public Investment Fund, would place \$5.3 bn of deposits in the banking system. (\$5.3 bn is about 1% of Saudi banks' total deposits.) At the same time, the Saudi Arabian Monetary Agency (SAMA – the Saudi Central Bank) announced that it would provide liquidity to banks through the introduction of seven- and 28-day repurchase agreements. Ninety-day agreements were introduced the following month.

In November, the Kingdom raised \$17.5 bn in its first ever sovereign bond issue, and a few days later began clearing delayed payments to contractors with an initial disbursement of \$11 bn.

The Kingdom raised a further \$9 bn through a sukuk issue in April 2017.

Of greater long-term significance have been the developments in public policy over the last year. Saudi Arabia's Vision 2030 was launched in April 2016 followed by its National Transition Plan (see pages 22–23).

In May 2016, Fahad al-Mubarak was replaced as Governor of SAMA by one of his deputies, Ahmed al-Kholify. (Al-Mubarak had been governor since 2011.) In November,

Mohammed al-Jadaan, the Chairman of the Capital Market Authority (CMA), was made Minister of Finance, replacing Ibrahim al-Assaf, who had been in that position for 20 years.

New banking licences issued

Further developments in the banking system occurred in April and May this year, when Citibank was awarded an investment banking licence by the CMA, and Bahrain's Gulf International Bank (GIB) was granted a local banking licence.

The GIB licence was particularly striking not only because SAMA rarely issues domestic banking licences, but also because GIB is incorporated outside Saudi Arabia (although it is 97% owned by the Saudi Public Investment Fund).

The last time domestic banking licences were issued were in 2008, when Alinma was licensed, and in 2005, when Bank Al Bilad was licensed. Prior to that, the most recent banking licence was that granted to Al-Rajhi Bank in 1987. But you have to go back several decades to find the last time when a bank that was not based in the Kingdom received a domestic banking licence.

Further change to the domestic banking scene is expected from a merger between Saudi British Bank (SABB) and Alawwal Bank. In April both announced that they were in discussions and in May SABB said that it had appointed Goldman Sachs to advise on the merger, while Alawwal announced that it would be advised by JP Morgan.

Alawwal was called Saudi Hollandi Bank until the end of 2016. For most of its history, ABM Amro Bank held a 40% stake and operated a management contract, but in 2007 Royal Bank of Scotland (RBS) acquired the stake as part of its acquisition of ABN Amro.

RBS has been reducing its overseas presence and selling subsidiaries around the world in an attempt to rebuild its capital levels after the global financial crisis, so the decision to sell the stake in Alawwal Bank was no surprise. Alawwal was the tenth largest Saudi bank at the end of 2016 and has consistently struggled in recent years to build market share. SABB was the fifth largest bank. Combined, the two banks are expected to be the third or fourth largest.

In March, Credit Agricole appointed JP Morgan to advise on the sale of its 31% stake in Banque Saudi Fransi. It will be interesting to see whether SAMA allows foreign banks to bid for Credit Agricole's stake, or whether it restricts the sale to Saudi buyers. Gulf banks are likely to be interested in buying Credit Agricole's shares, although few have the financial resources to do so.

Financial strength and profitability maintained

Despite the economic strains of recent years, Saudi banks have been able to maintain strong capital levels and

Summary financial statements of Saudi banks, 2015–2016

		Equity	Assets	Net loans	Customers' deposits	Net profit	ROAA	Cost/income	Loans/deposits	Capital adequacy (Basel ratio)
		\$mn*					%			
National Commercial Bank	2016	15,984.8	117,765.2	67,644.2	84,189.2	2,511.6	2.12	37.74	80.35	19.20
	2015	14,811.3	119,630.8	67,446.7	86,359.3	2,439.4	2.07	37.44	78.10	17.20
Al-Rajhi Bank	2016	13,856.5	90,616.2	60,015.9	72,712.6	2,167.6	2.48	32.38	82.54	21.98
	2015	12,436.4	84,160.3	56,054.8	68,748.3	1,901.2	2.29	33.88	81.54	20.83
Samba Financial Group	2016	11,411.6	61,748.2	33,405.5	45,900.2	1,335.2	2.15	32.92	72.78	22.50
	2015	10,762.0	62,727.7	34,665.0	45,811.8	1,390.4	2.30	30.93	75.67	20.10
Riyad Bank	2016	10,075.8	58,048.6	38,120.3	41,794.4	891.6	1.52	39.06	91.21	18.90
	2015	9,744.8	59,547.4	38,682.1	44,757.9	1,079.8	1.85	36.35	86.43	18.40
Saudi British Bank	2016	8,343.5	49,629.3	32,266.7	37,514.9	1,038.9	2.08	30.15	86.01	19.62
	2015	7,512.8	50,063.8	33,583.8	39,700.9	1,154.7	2.31	30.32	84.59	17.61
Banque Saudi Fransi	2016	7,922.0	54,263.4	34,532.1	42,267.9	936.3	1.81	33.58	81.70	17.78
	2015	7,328.6	48,990.3	33,003.3	37,825.0	1,076.3	2.17	33.26	87.25	17.16
Arab National Bank	2016	6,381.7	45,348.8	30,812.0	36,252.5	763.4	1.68	38.62	84.99	16.47
	2015	6,034.8	45,443.0	30,703.3	36,200.9	788.4	1.76	38.80	84.81	15.46
Alinma Bank	2016	5,115.8	27,936.1	18,755.3	21,502.8	400.7	1.55	45.07	87.22	20.00
	2015	4,893.9	23,658.5	15,200.6	17,476.8	392.0	1.73	41.60	86.98	23.00
Saudi Investment Bank	2016	3,612.6	25,170.4	16,071.1	17,535.8	280.9	1.12	43.66	91.65	19.13
	2015	3,209.5	24,952.7	16,070.7	18,803.8	354.3	1.42	41.17	85.47	16.94
Alawwal Bank (Formerly Saudi Hollandi Bank)	2016	3,431.1	28,026.9	19,403.8	22,769.0	284.0	1.00	36.24	85.22	17.81
	2015	3,207.1	28,817.1	20,303.8	23,687.2	539.3	1.98	32.20	85.72	15.58
Bank Al Jazira	2016	2,161.6	17,690.3	11,229.6	13,764.6	232.6	1.35	60.74	81.58	19.86
	2015	1,976.8	16,869.4	11,245.7	13,245.5	343.2	1.98	54.24	84.90	15.83
Bank Albilad	2016	1,952.8	14,375.5	9,650.4	10,732.4	215.8	1.54	59.62	89.92	20.46
	2015	1,717.8	13,658.0	9,134.0	11,247.2	210.2	1.63	61.64	81.21	15.88

* Original figures in Saudi riyals have been converted to \$s at an exchange rate of \$1=SR3.74891

Source: Financial statements of Saudi banks

reasonable levels of profitability.

All banks show risk-weighted capital ratios of at least 15% – nearly double the international standard. Returns on average assets range from 1% to around 2.5% despite the increased provisioning burden. Cost-to-income ratios for most banks are low: around 35–40%.

In March 2017, Moody's revised its outlook on Saudi banks to stable from negative – it had changed the outlook to negative from stable a year before. The rating agency cited its expectation that economic conditions would improve as a result of government spending as the reason for returning to a stable outlook, although it commented that profitability and loan performance were still likely to deteriorate during the following months.

Saudi banks' performance during early 2017 showed net

interest margins widening and operating profits increasing for some, though not all, banks.

Liquidity remains tight. Deposits across the system as a whole have hardly increased since the end of 2014. Private sector credit growth has slowed as a result. Saudi banks' loans-to-deposit ratios increased from 76% to 81% in the year to December 2016 (as calculated by SAMA), prompting SAMA to raise its maximum allowable ratio to 90% in February 2016. Nonetheless, the Saudi government appears to believe that Saudi banks' liquidity is easing – in July the Vice Minister for Economy and Planning confirmed plans to raise SR70 bn from local banks in the form of treasury instruments.

Another area to watch will be real estate lending, which showed a compound average growth rate of 24% in the four

years to the end of 2016. The increase has been prompted by new legislation that makes real estate lending more secure for banks, and by government initiatives to make finance more easily available.

A year ago, the government asked banks to reschedule real estate loans to those facing difficulties and this was followed

by another request to reschedule credit card loans.

Saudi banks have shown considerable resilience in recent years and they benefit from an attentive and experienced regulator. Their performance in 2018 will depend not only on the price of oil, but on the role that the public authorities ask them to play in maintaining economic prosperity. ■

Recent developments in Saudi finance

April 2016	Saudi government raises a \$10 bn loan from foreign banks.
May 2016	Alongside major changes to the government, Ahmed al-Kholify is appointed Governor of the Saudi Arabian Monetary Agency, replacing Fahad al-Mubarak. Al-Mubarak had been Governor since 2011. Al-Kholify had previously been Deputy Governor for Research and International Affairs.
September 2016	The government injects SR20 bn (\$5.3 bn) into local banks via deposits from state-run companies. SAMA introduces 7-day and 28-day repurchase agreements (and in October 90-day repurchase agreements). Benefits for public sector employees reduced. SAMA asks local banks to reschedule consumer loans of Saudis who will be affected by the reduction in public sector benefits.
October 2016	Saudi government issues \$17.5 bn international bond. SAMA asks local banks to reschedule property loans of Saudis whose incomes will be affected by the reduction in public sector benefits.
November 2016	Mohammed al-Jadaan replaces Ibrahim al-Assaf as Minister of Finance. Al-Assaf had been Finance Minister since 1996. Al-Jadaan had previously been Chairman of the Capital Market Authority.
January 2017	Budget statement announces intention to balance the budget by 2020 through increased non-oil income and reduced subsidies.
April 2017	Benefits for public sector employees that had been reduced in September 2016 are restored. Saudi government issues \$9 bn in sukuk. Saudi British Bank and Alawwal Bank (formerly Saudi Hollandi) announce plans to merge.
May 2017	Governor of SAMA says he does not expect to see more bank mergers but that SAMA has an 'open policy' towards the licensing of foreign banks. Bahrain-based, Saudi-owned Gulf International Bank receives local banking licence. Mohammed Al-Tuwaijri, Vice Minister of Economy and Planning says that domestic banks "are pretty liquid now and their ability to invest in government bonds is good," adding that the government plans to raise about SR70 bn (\$18.7 bn) from local banks during the course of the year.

Profile of the Saudi banking system, 2012–2016 (\$mn, unless otherwise stated)

	End-2016	End-2015	End-2014	End-2013	End-2011
Claims on private sector	374,902	365,953	335,087	299,726	266,511
Claims on government	60,665	33,337	26,394	25,009	21,893
Foreign assets	60,241	84,480	67,116	56,201	56,771
Total assets	601,864	589,176	568,852	505,022	462,572
Deposits	431,328	428,062	420,277	373,970	336,260
Capital and reserves	90,495	83,663	76,894	69,766	64,819
Real estate loans (corporate and retail)	55,182	49,738	42,408	31,943	23,480
Consumer loans	91,181	87,246	83,517	76,793	70,205
Growth in private sector credit (%)	2.4	9.2	11.8	12.5	
Loans/deposits (%)	87	85	80	80	79
Loans/assets (%)	72	68	64	64	62