FitchRatings

Saudi Arabian Banks – Peer Review

Well-Contained Impact of the Pandemic, Recovering Operating Environment

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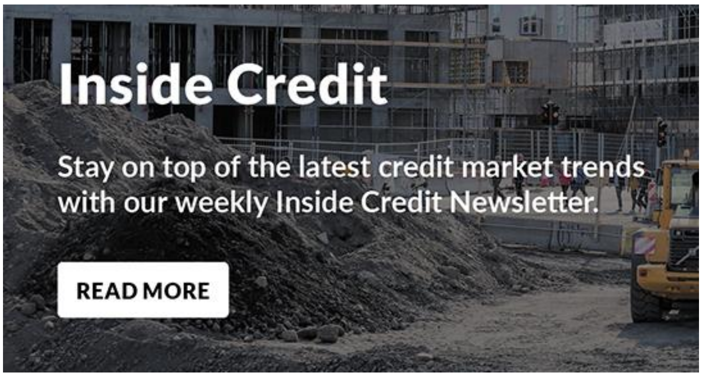
> 'Operating environment pressures from the pandemic have reduced, helped by recovering oil prices, high credit growth and resuming economic activity. Saudi banks have absorbed the shock for the main part and financial metrics are stabilising. Further asset-quality deterioration will be contained.'
>
> Amin Sakhri, Director, Fitch Ratings



Related Research

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The impact of the pandemic on Saudi Arabian banks has been contained. Pressures on the operating environment have eased and the economic activity is gradually recovering, supported by higher oil prices. Deterioration in asset quality and profitability was limited and the banks' financial metrics have stabilised.

These have been underpinned by government support measures that included interest-free deposits, but also by the strong loan growth in 2020 and 1H21 (14.9% and 19.0%, respectively) that was boosted by the sustained momentum in retail mortgages. Delayed recognition of impairments remains a key risk but Fitch Ratings believes the impact on the sector's asset quality and overall financial profiles will be contained.

Saudi Banks on Stable Outlook

Fitch revised the Outlook on all Saudi banks' Long-Term Issuer Default Ratings (IDRs) to Stable in 2Q21 and 3Q21 to reflect reduced pressures on the operating environment and the Stable Outlook on the sovereign rating. Saudi banks' weighted average Viability Rating (VR) of 'bbb+' remains the highest in the Gulf Cooperation Council (GCC).

Pressures on the operating environment from the pandemic and lower oil prices are easing, helped by recovering global oil demand and up-ticking non-oil economic activity. Some sectors remain under pressure and the operating environment has not fully recovered but we believe the downside risk for banks has reduced.

Contained Deterioration of Asset Quality

The sector's reported asset-quality metrics were stable in 2020 despite the increasing stocks of Stage 2 and Stage 3 loans. They were supported by government forbearance measures and by high credit growth from strong retail mortgage origination.

The recovery in the operating environment consolidated this trend in 1H21, with the loan impairment charges (LICs)/average gross loans ratio reducing to 0.8% from 1% in 2020.

Fitch believes further deterioration in asset quality, from the withdrawal of forbearance measures in particular, will be overall containable for Saudi banks.

Capital Buffers Still Sound; Strong Liquidity

The sector's capitalisation remains sound, with an average common equity Tier 1 (CET1) ratio of 18.1% at end-1H21, one of the highest globally. This was despite high credit growth and increasing LICs from the challenged operating environment. Saudi banks' balance sheets remain very liquid; this is supported by large amounts of government deposits which have been in place since 1Q20.

Banking System Overview

	End-2019	End-2020
Banking system total assets/GDP (%)	90	114
Retail credit/total credit (%)	36	39
Credit growth (%)	7.7	14.9
Non-performing loan ratio (%)	1.9	2.2
Operating return on risk-weighted assets (%)[a]	2.5	2.2
Common equity Tier 1 ratio (%)[a]	17.8	18.2
Loans/customer deposits (%)[a]	85.4	88.1

[a] Based on Fitch-rated banks
Source: Fitch Ratings, SAMA

High Probability of Sovereign Support

Fitch believes the Saudi authorities have a strong ability to provide support to the banking system due to the Saudi sovereign's strong financial flexibility as shown by the sovereign rating (A/Stable). External reserves are still large and the kingdom's access to international debt capital markets has increased.

There is a long record of support for Saudi banks and Fitch considers that the authorities still have a strong willingness to support the banking sector to maintain stability in the domestic financial system.

Globally, governments' propensity to provide support to banks has waned, employing bank resolution legislation to "bail in" certain creditors and using insurance schemes to protect depositors. Saudi Arabia, an FSB/G20 member country, introduced bankruptcy legislation several years ago with resolution legislation following in 4Q20. However, we do not believe the authorities will use such legislation over sovereign support. If this view changes, we will review the Saudi banks' Support Rating Floors (SRFs) and this could result in downward revisions of the SRFs, even to 'No Floor'. However, this is not our base case.

Fitch views all rated banks in Saudi Arabia as domestic systemically important banks (D-SIBs) and considers that size, franchise, funding structure and level of government ownership should not necessarily lead to a difference in Saudi banks' SRFs due to the important role they all play in building the economy. As a result, the SRF of all rated banks is equal to the D-SIB SRF of 'BBB+'.

Fitch-Rated Saudi Banks

Bank	Long-Term IDR	Outlook/ Watch	VR	SRF
The Saudi National Bank (SNB)	A-	Stable	a-	BBB+
Al Rajhi Banking and Investment Corporation (ARB)	A-	Stable	a-	BBB+
Riyad Bank	BBB+	Stable	bbb+	BBB+
The Saudi British Bank (SABB)	BBB+	Stable	bbb+	BBB+
Banque Saudi Fransi (BSF)	BBB+	Stable	bbb	BBB+
Arab National Bank (ANB)	BBB+	Stable	bbb	BBB+
Alinma Bank	BBB+	Stable	bbb	BBB+
The Saudi Investment Bank (SAIB)	BBB+	Stable	bbb-	BBB+
Bank Aljazira (BAJ)	BBB+	Stable	bb+	BBB+
Gulf International Bank – Saudi Arabia (GIB SA)	BBB+	Stable	NR	BBB+

Source: Fitch Ratings

Easing Operating Environment Pressures

Recovering Operating Environment

Pressures on the banks' operating environment from the pandemic and lower oil prices have eased in our view. Fitch expects real GDP growth of 1.5% in 2021 and 3.8% in 2022, which reflects a benign and recovering operating environment supported by higher oil prices.

Some non-oil sectors remain under pressure, with corporates' ability to service their debts weakened as some are still absorbing the shock of 2020, but we believe these pressures are already captured by the banks' adequate provisioning and classification. The pandemic has put pressure on the sovereign's financial flexibility and ability to spend in the economy, although this has been less than anticipated and recovering oil revenue continue to mitigate it.

Saudi Sovereign Outlook Revised to Stable

On 15 July 2021, Fitch revised the Outlook on Saudi Arabia to Stable from Negative and affirmed the IDR at 'A'. This reflected prospects for a smaller deterioration in key sovereign balance-sheet metrics than at the previous review in November 2020 owing to significantly higher oil prices and continued government commitment to fiscal consolidation.

Growth and Government Support Soften Impact on Banks

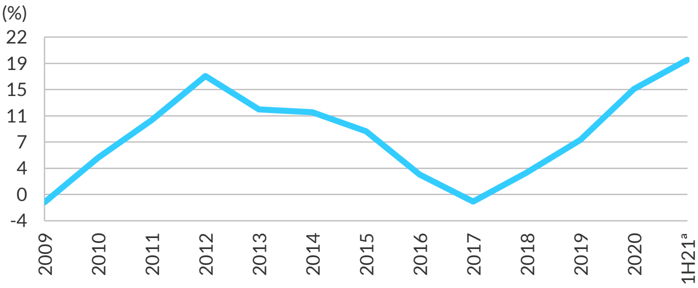
The effects of the pandemic have been visible since 1Q20. The cut in interest rates by SAMA, the Saudi central bank, to a record low of 1% has put pressure on margins. Low trade volumes and economic activity have also reduced fee-income generation. LICs increased in 2020 as banks built up provisions due to weaker credit conditions amid the pandemic.

The impact of Covid-19 was largely softened by high loan growth in 2020. Growth was driven by retail mortgages, which are stimulated by the government, and this trend continued with 9.5% lending growth in 1H21. LICs started to fall in 1H21, consuming a lower 21% of pre-impairment operating profit (2020: 26%), which is just above pre-pandemic levels.

High growth in the lower-risk retail mortgage segment supports the sector's financial metrics overall and these have been only moderately affected by the pandemic. In addition, profitability and liquidity have been underpinned by large amounts of government interest-free deposits in the system.

The true impact of asset-quality deterioration remains masked by loan deferral and regulatory forbearance until end-3Q21 but we expect the impact to be well contained, in particular at retail-focused banks. A return of lockdown measures and additional waves of the pandemic, exacerbating pressures on the operating environment, is the downside risk.

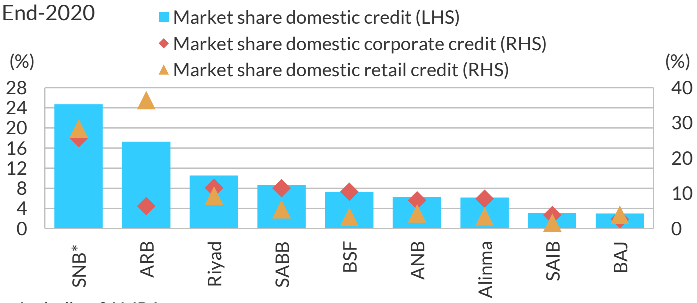
Saudi Credit Growth



ª Annualised data
Source: Fitch Ratings, SAMA

Market Share of Domestic Credit

End-2020



ª Including SAMBA
Source: Fitch Ratings, Banks, SAMA

Still Sound Capital and Liquidity Buffers

Saudi banks have strong capital buffers (average CET1 ratio: 18.1% at end-1H21 for Fitch-rated banks). We do not expect these buffers to weaken significantly as internal capital generation is likely to be supported by a recovery in the banking sector's profitability.

The SAMA-calculated sector loans/customer deposits ratio of 77.4% at end-July 2021 was well below the 90% regulatory ceiling. We expect the withdrawal of SAMA's support deposits to be gradual and manageable for banks. The sector continues to benefit from a high proportion of low-cost stable customer deposits, deepening capital markets and generally high government deposits.

Unprecedented Government Support Package

In response to the crisis, the Saudi government unveiled hefty support packages and unprecedented measures to soften the impact on the banks and support the economy. Fitch estimates the combined size of the packages at SAR261.9 billion (10% of GDP). These include support to SMEs and larger private-sector entities through the deployment of liquidity in the banking system to allow relief on existing debts, and granting of new loans. Further to this, SAMA cut its official repo rate in March 2020 by 125bp to 1%.

Unlike some GCC countries, SAMA did not relax regulatory and macro prudential requirements for banks, reflecting the comfortable buffers that banks already enjoy over their minimum requirements. This stance will incentivise banks to maintain strong regulatory capital and liquidity positions, and help maintain a solid banking sector.

Company Profile; Management and Strategy; Risk Appetite

Saudi banks' company profiles benefit from limited competition. Banks have very similar business models and focus predominantly on the domestic market. SNB is the only bank in the sector with notable overseas operations through its Turkish subsidiary Turkiye Finans Katilim Bankasi A.S. (B+/Stable/b+). Business models are traditional, with retail- and corporate-banking operations supplemented with conservative treasury operations and client-driven investment banking.

Stable Company Profiles, Except SNB

ARB and SNB are the two largest banks, together supplying about 42% of domestic credit and 65% of retail credit at end-2020. ARB is the dominant retail bank, supplying about 37% of retail credit. SNB's leading position in the corporate segment is less dominant at 26%, but it has strengthened following its merger with SAMBA Financial Group and SNB is also the second-largest retail bank (28% share) in the kingdom.

On 1 April 2021, the National Commercial Bank (NCB) and SAMBA merged; the merged bank has been renamed SNB and has retained NCB's banking licence, while SAMBA ceased to exist as a legal entity.

SNB reinforced its position as the kingdom's largest bank by total assets, and is the third-largest bank in the GCC region, while its domestic market shares in loans and deposits of about 25% and 30%, respectively, are well above SNB's pre-merger shares of 17% and 20%. Strong synergies between the banks in retail, corporate and treasury portfolios create a very strong domestic bank.

SABB's position as a leading corporate lender was strengthened following its merger with Alawwal in June 2019 and the bank now has a market share of lending of about 11%. However, SABB's market shares in overall domestic credit (9%) and retail (5%) are below those of Riyad, which has solid market shares in both corporate (11%) and retail (9%).

BSF and ANB have market shares of domestic credit of 7% and 6%, respectively. They are mainly corporate banks with a market share of at least 8% in domestic corporate lending.

The remaining banks are smaller, with market shares of 6% or less. We view Alinma's franchise as the strongest among the smaller banks and more comparable to medium-sized banks given the bank's rapid growth since inception and competitive advantage in financing government projects.

Experienced Management; Differences in Execution

Senior management teams are generally stable and experienced in a regional context. We view the strength of SABB's management team as being at the higher end of the sector given the positive influence and the presence of seconded senior management from HSBC.

Strategy execution is generally sound in our view, with banks recording healthy profits despite the ongoing pressures in the operating environment and the pandemic. In particular, Saudi banks' performance in 2020 and 1H21 was largely supported by high growth in retail assets, which absorbed the impact of the pandemic on the sector's execution for the main part and profitability metrics remained resilient.

Nonetheless, we see differences in execution. ARB's strong execution reflects its competitive advantage in retail and exceptionally low funding costs. This allows the bank to attract a larger portion of new retail financing than peers and to outperform these consistently. Execution has historically been slightly weaker at SNB, partly due to higher provisioning requirements in Turkey.

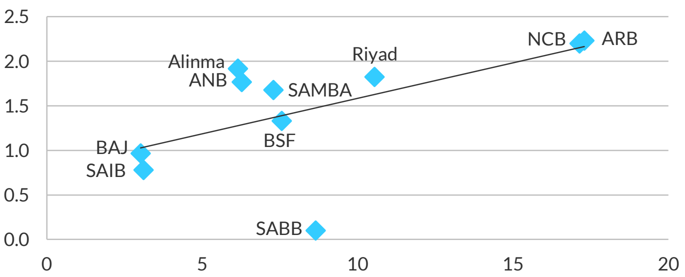
Riyad's execution is improving on the back of more contained LICs and management keeping a tight rein on costs but is not as strong as larger peers'.

SABB is typically posting higher profits than its market shares would suggest owing to very low LICs historically, high cost efficiency and low funding costs. SABB's profitability plummeted in 2020 due to a high one-off goodwill impairment charge following the Alawwal acquisition.

SAIB and BAJ have the highest funding costs in the sector, reflecting their smaller and weaker franchises, lower portion of non-interest bearing (NIB) deposits, but also higher LICs than most peers' in the case of BAJ.

Performance vs. Market Share

X-Axis: Market Share (%, FYE20) / Y-Axis: Average ROA (%, 4yr avg)



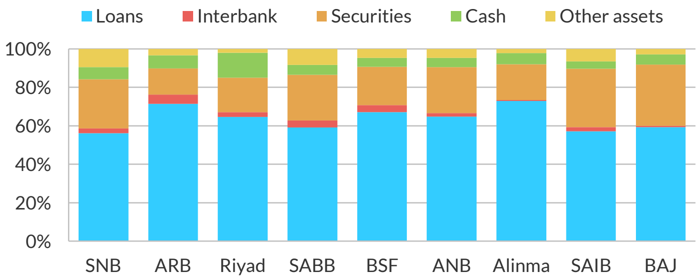
Source: Fitch Ratings, Banks

Stable Risk Appetite

Banks have similar asset composition, with loans comprising 61% of assets on average. However, some banks are below average, instead opting to hold larger investment books than peers. This supports their asset quality as their investment portfolios almost entirely comprise investment-grade debt.

Total Assets Composition

End-1H21



Source: Fitch Ratings, Banks

Concentrations on both sides of the balance sheet remain a key credit weakness, as the Saudi economy remains undiversified and wealth is concentrated.

The government exerts significant influence on the private sector. The result is that primary borrowers are large family-owned conglomerates and government-owned corporates. While the retail segment is increasing and accounts for 39% of total credit, this is not sufficient to reduce lending concentrations significantly, and the 20 largest loans average a high 26% of gross loans. ARB, as the largest retail bank, is a clear outlier as its concentration is lower.

There are also concentrations in funding, due primarily to large government-agency deposits. Liquidity risk is still present, as shown by the outflow of government deposits in 2016. Nevertheless, the deposit withdrawal was fairly short-lived and we do not expect this to be repeated, especially as the authorities have deposited significant amounts in the system since 1Q20 to support liquidity.

Limited Market Risk

Market risk is modest at Saudi banks. It is characterised by low interest-rate risk given a low-interest-rate environment and a high portion of NIB deposits. Currency risk is also limited by small foreign-currency books and a solid peg between the Saudi riyal and the dollar. Banks' investment portfolios are generally very conservative, mainly comprising Saudi government issuances and other investment-grade securities.

Limited Impact of Islamic-Banking Features on Ratings

About 80% of the Saudi banking sector financing is Islamic. However, only three banks are fully Islamic (ARB, Alinma and BAJ) and the impact on their ratings is limited. Being Islamic generally benefits these banks' company profiles and franchise. This is significantly more pronounced at ARB as the bank has the leading retail franchise and sees substantial benefits of this on its funding profile.

Islamic banks need to ensure compliance of their operations with sharia principles, which entails additional costs, processes, disclosures, regulations, reporting and sharia audit. This affects these banks' corporate governance and is factored into our ratings. In addition, Islamic banks have certain sharia limitations embedded in their operations and obligations, although this only has a minimal credit impact on the entities.

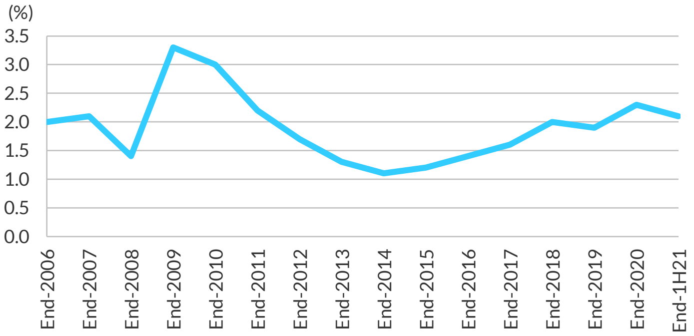
We see little impact of following Islamic law on the financial profiles of Islamic banks in Saudi Arabia. In particular, the use of the alpha factor (which allows profit- and loss-sharing deposits to be partially discounted from risk-weighted assets for Islamic banks) has not been adopted by SAMA, unlike some regulators in the GCC. The impact on the sector's capitalisation is therefore limited.

Asset Quality

Headline asset-quality metrics remain strong by global standards. The sector's non-performing loan (NPL) ratio of 2.1% at end-1H21 (end-2020: 2.2%; end-2019: 1.9%) remains contained despite the pandemic. Strong loan growth has softened the impact of higher impairments on asset-quality metrics.

The true effect of asset-quality deterioration remains masked by loan deferral and regulatory forbearance until end-2021 but we expect the impact to be well contained, in particular at retail-focused banks. A return of lockdown measures and additional waves of the pandemic, exacerbating pressures on the operating environment, is the downside risk.

Sector NPL Ratio



Source: Fitch Ratings, SAMA

Some of the pressure in recent years has come from the construction sector, with delayed government payments affecting subcontractors and related sectors, the postponement of projects and a smaller project pipeline. This has now stabilised and losses are not expected in the same magnitude. The delayed economic impact of the pandemic could undermine this progress, although the government has pledged SAR50 billion to ensure timely payments to the sector. Retailers and car dealers continue to suffer from lower consumer confidence, which had been affected by geopolitical tensions in previous years.

Low levels of impairment in the kingdom reflect several factors in our view, including the prevalence of large conglomerates and government-owned corporates with generally low leverage as the largest borrowers. They also reflect a small but very safe retail lending structure, in which almost all lending is salary-assigned and repayment is deducted directly from a borrower's salary.

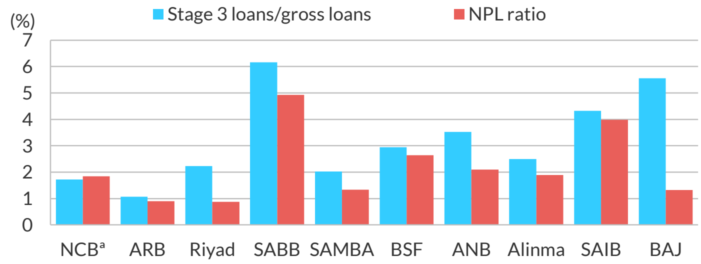
High retail lending growth continues to support this trend to some extent and mitigate expected losses on the banks' corporate lending books.

Low LICs historically also reflect a culture of restructuring and renegotiation of loans instead of classification and enforcement due to a cumbersome legal process, particularly in the troubled contracting sector. LICs increased in 2020 due to Covid-19 as asset quality deteriorated but have stabilised in 1H21 and the LICs/average gross loans ratio of 0.8% is marginally below its pre-pandemic level (2019: 0.9%). This is indicative of a stabilisation of sector asset quality.

Improved Loan Classification under IFRS 9

Weaknesses in loan classification were highlighted by the introduction of IFRS 9 in 1Q18 and reported NPLs continue to be lower than Stage 3 loans (Fitch's definition of impaired loans). For the nine Fitch-rated banks with a VR, the weighted average Stage 3 loans ratio at end-2020 was 2.6%, slightly higher than the average NPL ratio under the former classification (end-2020: 2.2%).

NPLs vs. Stage 3 Loans

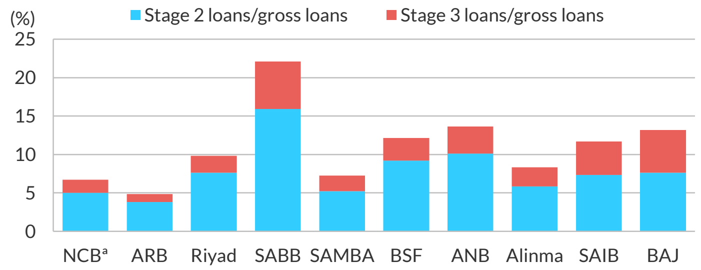


[a] Data are pre-merger
Source: Fitch Ratings, Banks

Fitch still views IFRS 9 disclosures as difficult to compare across the banks for Stage 2 loans given the scope for different assumptions between banks.

Stage 2 and 3 Loans/Gross Loans

End-2020



[a] Data are pre-merger
Source: Fitch Ratings, Banks

Reserve Coverage Deteriorates but Remains Healthy

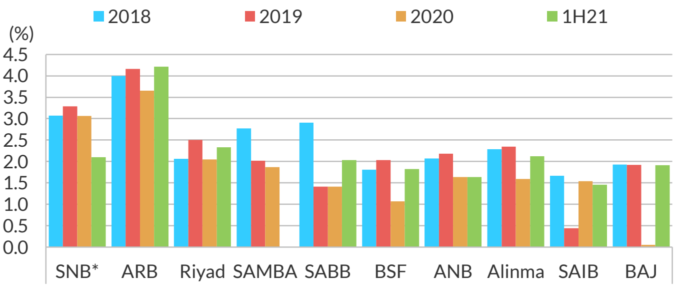
Reserve coverage of Stage 3 loans is weakening due to rising impairments but is healthy with an average of 110% for the sector at end-2020; it is above 100% for most banks.

Earnings and Profitability

Profitability is a rating strength for Saudi banks. The impact of the pandemic on the sector's earnings and profitability metrics has been contained with Saudi banks recording a healthy operating profit/risk-weighted assets ratio of 2.4% in 1H21, which is in line with pre-pandemic levels (2020: 2.2%; 2019: 2.5%).

Net interest margins have been under pressure from large rate cuts since 1Q20. This has been partly offset by lower funding costs since 1Q20 (peer average in 1H21: 38bp; 2020: 60bp; 2019: 110bp) owing to large interest-free deposits injected by SAMA, and by growth in higher-margin retail mortgages.

Operating Profit/Risk-Weighted Assets



[a] 2018-2020 data are pre-merger
Source: Fitch Ratings, Banks

LICs have risen since 1Q20 due to higher expected credit losses as asset quality deteriorated, but the impact has been moderate with LICs consuming only 21% of pre-impairment operating profit on average in 1H21 (2020: 26%; 2019: 19%) and pre-impairment operating profits boosted by high sector growth. High LICs will continue to exert pressure on the sector's profitability as asset quality deteriorates, but we expect the impact to be contained.

Banks with a stronger retail franchise were less affected as LICs are typically lower in the retail segment. As retail loan books do not reprice as quickly, the impact of lower rates on net interest margins was also less accentuated.

Franchise Advantages Drive Profitability

ARB has consistently reported the strongest profitability in the sector, reflecting its dominant retail franchise and by far the highest market share in NIB deposits. This translates into extremely low funding costs (16bp in 1H21) and a net financing margin well above peers'.

SNB is the second most profitable bank in our view and also enjoys a high market share in NIB deposits owing to its dominant franchise. Profitability is supported by a greater focus on retail and, therefore, better margins than peers'. The bank's Turkish operations also support margins but put pressure on LICs, cost of funding and operating costs. We expect synergies from the merger with SAMBA to further support SNB's profitability.

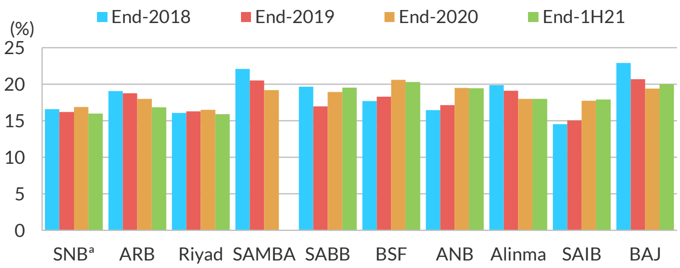
Profitability at Riyad and SABB benefits from their strong franchises, which also result in low funding costs, albeit just around the peer average of 38bp in 1H21. SABB's profitability suffered in 2020 from a high one-off goodwill impairment charge but the bank recovered well in 1H21.

Smaller banks are less profitable, typically due to more limited franchises and higher funding costs. This hampers their ability to generate similar levels of pre-impairment earnings as larger peers, in particular at BAJ and SAIB, and Alinma to some extent. LICs are also typically higher at smaller banks as their lending books do not perform as strongly as larger peers'. Nevertheless, Alinma's return on average assets is closer to the larger peers' owing to its growing franchise.

Capitalisation and Leverage

The Saudi banking sector benefits from strong capital buffers and capitalisation remains a key strength of the banks' financial profiles. These buffers have been built from strong profitability in previous years and are underpinned by healthy reserve coverage of NPLs.

Common Equity Tier 1 Capital Ratio



[a] End-2018-2020 data are pre-merger
Source: Fitch Ratings, Banks

Capital Buffers Remain Strong

Capitalisation compares well with international peers' considering that most banks have corporate-focused business models with standardised risk-weightings. The risk-weight density across the Fitch-rated banks with a VR was 76% at end-1H21. High capital ratios reflect tight regulation (under which banks are subject to individual undisclosed Pillar II add-ons in addition to the minimum regulatory requirements) and lower loan growth in recent years.

The sector maintained high capital ratios in 1H21 despite pressure from the operating environment. High sector growth and rising LICs led to capital erosion at some banks (albeit moderately) and banks maintain high capital ratios. The peer average CET1 ratio was a still strong 18.1% at end-1H21 (end-2020: 18.2%; end-2019: 17.7%), as capitalisation remained underpinned by healthy internal capital generation at most banks, balancing the effect of higher LICs and loan growth.

Not Just Core Capital

Capital ratios at some banks are boosted by additional Tier 1 capital, subordinated debt instruments and additional reserves. SNB (180bp of RWAs), SAIB (251bp) and BAJ (296bp) had additional Tier 1 capital instruments at end-1H21 to supplement core capital.

Banks also benefit from additional buffers of Tier 2 capital and general provisions allowed under SAMA regulation. In particular Riyad's, ANB's and BAJ's total capital adequacy ratios benefit from subordinated issuances. The smaller banks, which generate less capital organically, tend to have higher recourse to Tier 2 capital, although larger banks also issue to take advantage of lower rates and bolster their non-core capital buffers.

Lower Dividends Supported Capitalisation

Distributions to shareholders increased gradually to 65% of net income in 2019 from 41% in 2015. This reflects already strong buffers in a lower loan-growth environment in previous years.

Distributions reduced to 28% of net income in 2020 to mitigate the impact of the pandemic and preserve capital buffers. Fitch views capital at banks as sufficient for growth and for unexpected losses.

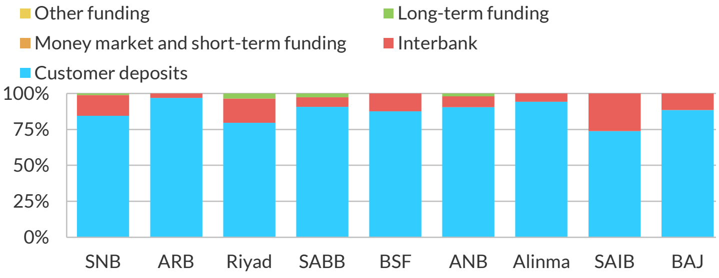
Funding and Liquidity

Funding Mostly Customer Deposits-Driven

Banks are funded mainly by customer deposits. These accounted for about 87% of total non-equity funding at end-1H21. Banks also benefit from a large proportion of retail NIB deposits, which is supported by the high proportion of Islamic banking in the kingdom (about 80%). ARB benefits most given its Islamic bank status and its dominant retail franchise.

Funding Mix

End-1H21



Source: Fitch Ratings, Banks

We view ARB's funding profile as exceptionally strong given the bank's high portion of current and savings accounts. We also view SNB's funding profile as very strong, albeit less so, underpinned by the bank's dominant position.

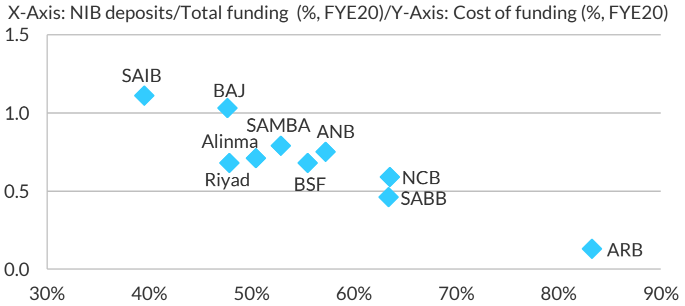
The use of wholesale funding at BAJ (interbank funding), SNB (repo market) and SAIB (short- and long-term wholesale funding) is high relative to peers and increases these banks' funding costs. Turkiye Finans Katilim Bankasi also pushes up SNB's funding costs.

The sector has low needs for and reliance on foreign-currency funding. Funding costs have benefited from large government deposits at 0% interest rate since 1Q20; these were deployed as part of the authorities' support package.

The prevalence of short-term deposits leaves large mismatches on the banks' balance sheets as funding of long-term lending by short-term deposits exposes banks to the risk of sharp liquidity outflows, particularly for corporate-focused banks. Nevertheless, a large proportion of deposits are NIB deposits, either from government agencies or from retail customers and deposits are behaviourally stable as they are predominantly domestic.

Deposit Mix vs. Funding Costs

X-Axis: NIB deposits/Total funding (%, FYE20)/Y-Axis: Cost of funding (%, FYE20)



Source: Fitch Ratings, Banks

The high portion of NIB deposits largely drives the banks' low funding costs. ARB has a substantial advantage as both a retail and an Islamic bank, with a large 82% of its funding coming from NIB deposits, which leads to remarkably low funding costs. The smaller banks have the lowest proportion of NIB deposits, which translates into higher funding costs.

The contribution of NIB deposits is likely to remain stable with lower interest rates as opportunities to maximise yields will be scarcer. Islamic banking is at the core of the Saudi banking system and many of these NIB deposits come from the growing retail segment. ARB and SNB generate the largest share of NIB deposits due to stronger retail franchises.

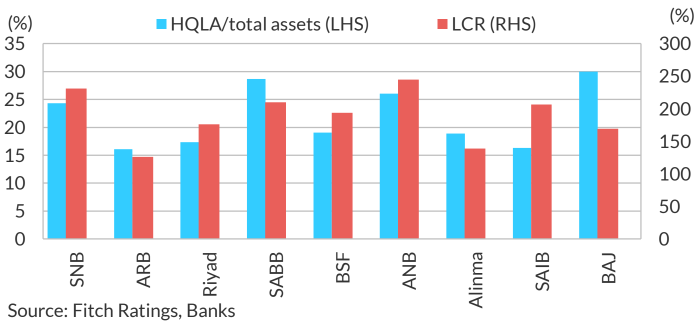
Deposit concentration is high for most Saudi banks, with the 20 largest deposits accounting for about 32% of total deposits on average. Retail banking is developing but the government and quasi-government sector still provide a material portion of the system's deposits. Concentration risk is a weakness although it is contained in our view and mitigated by the largest deposits being mostly from the government and expected to remain stable.

High liquidity in the banking sector mitigates funding weaknesses, such as concentration. Liquidity has benefited from limited lending opportunities in recent years and has been parked in conservative investment portfolios. The latter consists mostly of government securities, primarily from Saudi Arabia, but also other GCC countries for diversification purposes. High-quality liquid assets accounted for between 16% (ARB and SAIB) and 30% (BAJ) of total assets at end-1H21, which is sound.

However, lending growth has resumed since 2019 and exerts pressure on the liquidity ratios of some banks, although these are still sound and within regulatory requirements. In particular, the Fitch-calculated sector loans/deposits ratio increased to 92% at end-1H21 from 85% at end-2018 but is healthy. Liquidity has been supported by additional large government deposits since 1Q20 amid the pandemic, which mitigates the impact of high loan growth.

Liquidity Summary

End-1H21



Source: Fitch Ratings, Banks

Liquidity has been increasing in recent years, helped by the liquidity coverage ratio being phased in. The average liquidity coverage ratio is high, with a peer average of 189% at end-1H21 (end-2020: 209%), benefiting from strong liquidity and a high contribution of retail deposits to total deposits. Banks also disclose their net stable funding ratios and all are well over the 100% minimum requirement.

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