Saudi Banking Sector 2021 Outlook
Growth Hinges On Mortgage Lending And Public Spending

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S&P Global
Ratings

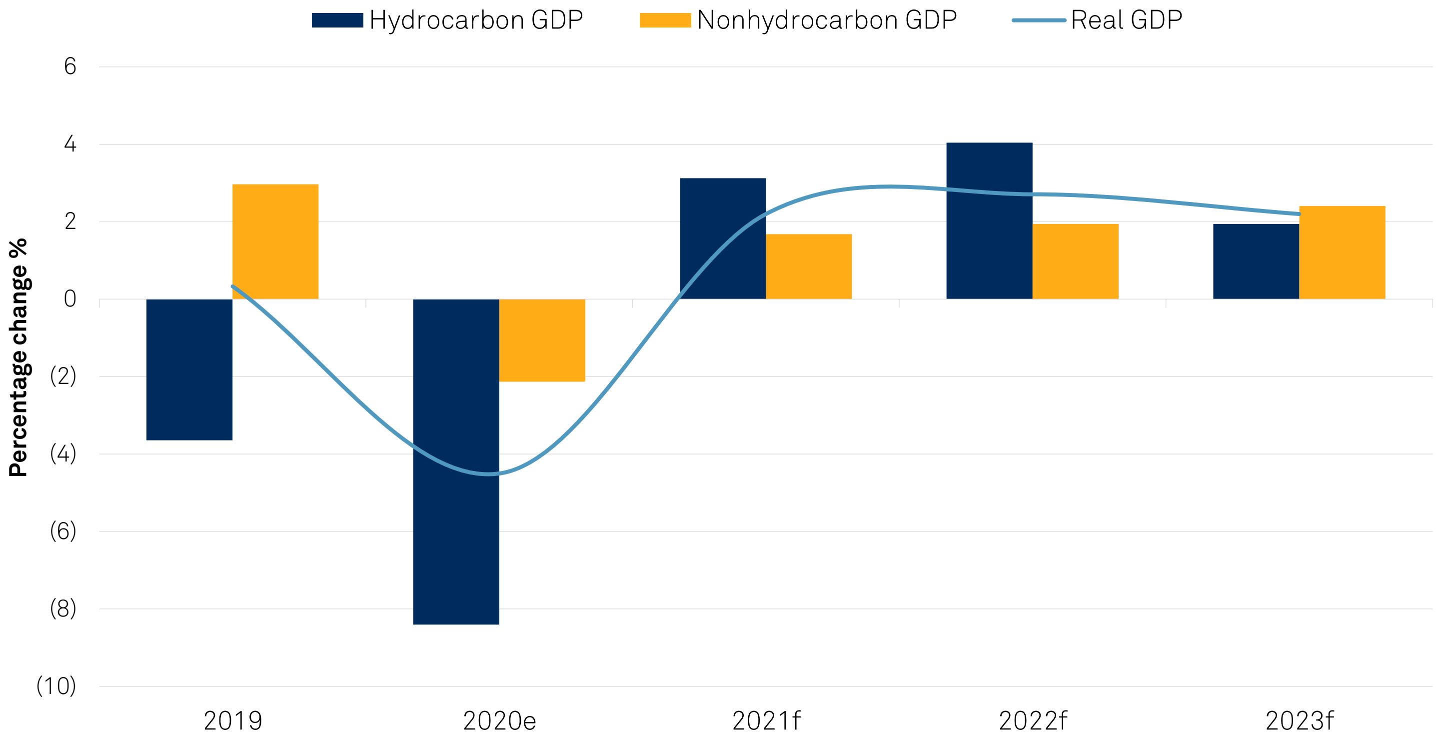
Key Takeaways

- The Saudi economy will recover in 2021-2022 from the shocks of 2020 as global demand for oil recovers and private consumption increases. That said, real GDP will not return to 2019 levels until 2022, in our view.
- The roll out of the vaccine may help avoid further lockdowns but remains contingent on availability. In addition, downside risks related to the virus remain.
- We expect credit growth to stabilize in 2021 or reduce slightly. Mortgage origination will remain buoyant and corporate lending is likely to pick up as Public Investment Fund programs create business for contractors.
- Cost of risk will remain elevated in 2021, despite stronger-than-expected estimates for 2020, as the Saudi Central Bank lifts its forbearance measures. Combined with very low interest rates, this will weigh on banks' profitability.
- We expect ratings on banks to remain stable in the next 12-24 months. The merger between National Commercial Bank (NCB) and Samba Financial Group (SFG) may create a national champion that could focus on financing large strategic projects.

Saudi Economy Will Recover In 2021 After 2020 Shock

Saudi Economy To Recover In 2021 As OPEC+ Cuts Gradually Expire

Saudi Arabia annual real GDP growth: production



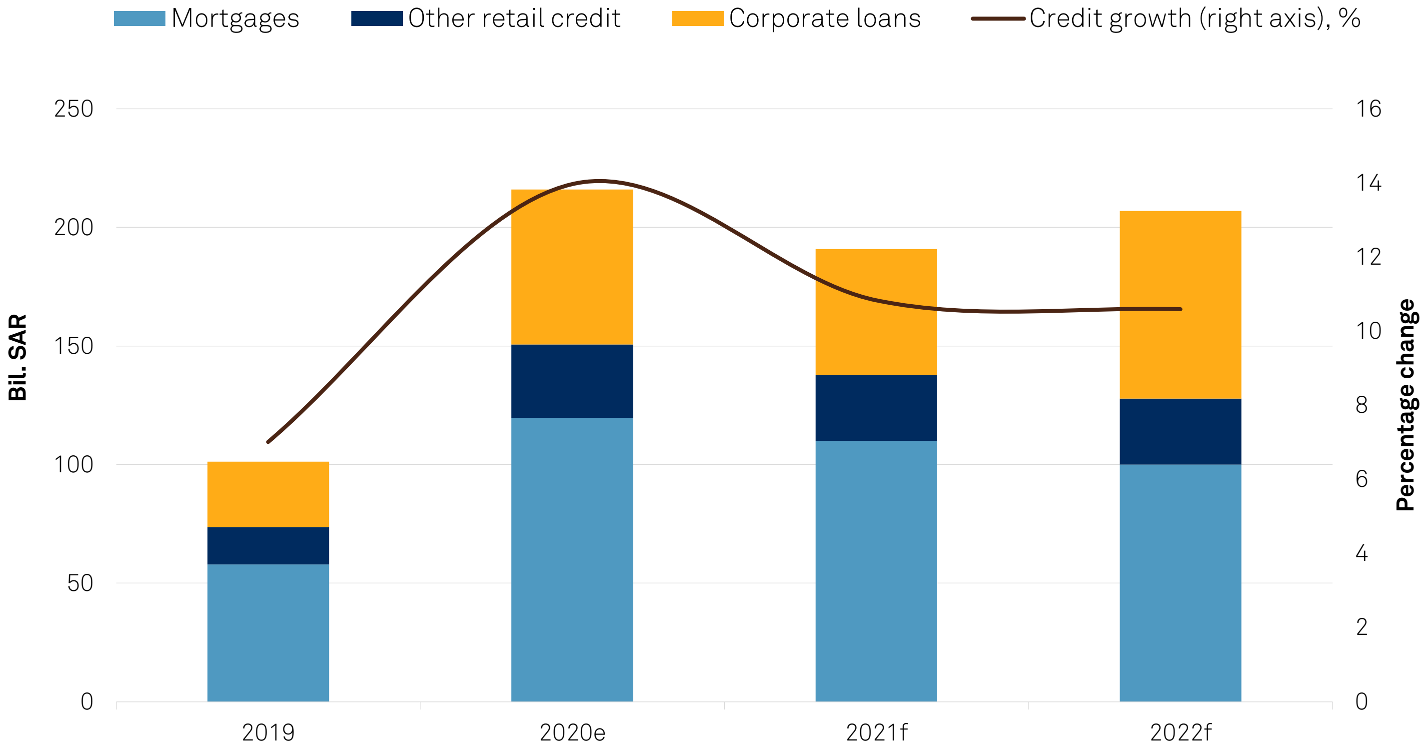
Source: S&P Global Ratings. e--Estimated. f--Forecast.

- OPEC+ related oil production cuts and the impact of the pandemic on important economic sectors eroded real GDP in 2020 by over 4% and triggered a sharp decline in Saudi Arabia's net exports.
- By 2022, we expect the expiry of OPEC+ quotas and higher oil prices to boost economic activity to close to 3%.
- In the years ahead, the government will continue to pursue its Vision 2030 program, which largely aims to support the non-oil economy and social transformation of the country via a series of large projects.
- Downside risks related to the pandemic remain significant.

Corporate Credit Will Pick Up In 2021

Credit Growth Will Remain Strong In 2021-2022 Boosted By Corporate Segment

Net change in credit by sector

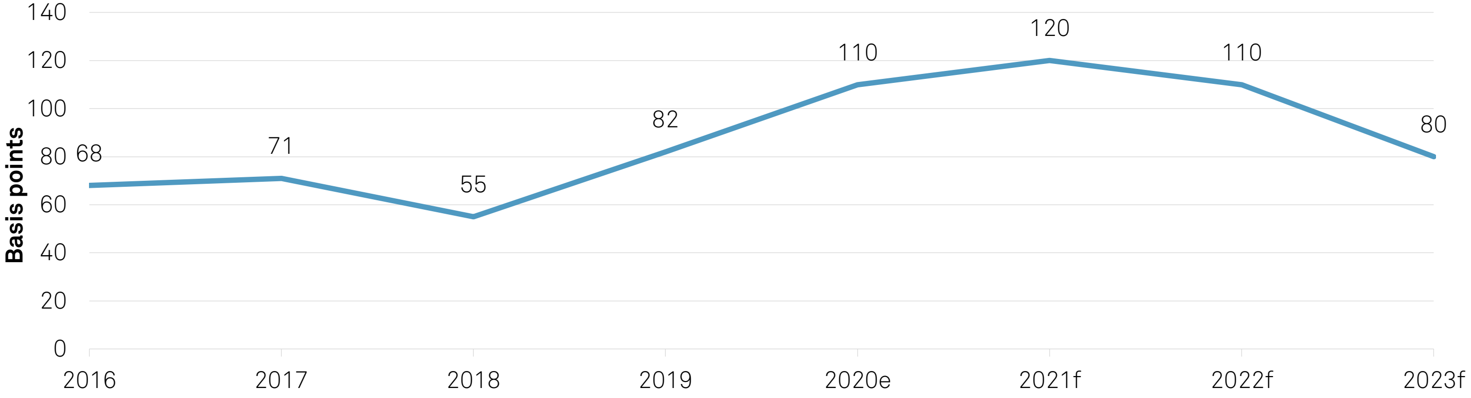


e--Estimated. f--Forecast. SAR--Saudi riyal. SME--Small and midsize enterprise. Source: S&P Global Ratings.

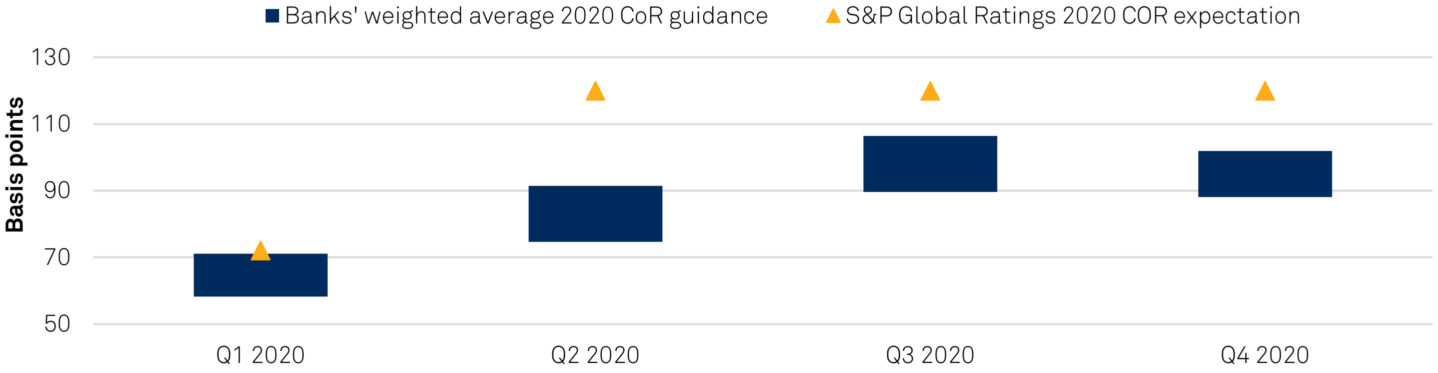
- **Credit growth picked up in 2020** based on stronger mortgage and small and midsize enterprise (SME) lending.
- **We expect credit growth to stay strong** in nominal terms in 2021-2022, but to slow down due to high-base effect.
- **Corporate credit growth may pick up** as Public Investment Fund programs generate business for contractors.
- **SME credit to slow down** as deferral programs are wound out, but remain material because of subsidies.
- **Retail credit growth will stay strong** due to continued focus on mortgages, although the market will gradually saturate.

Cost Of Risk Will Stay Elevated Until 2022-2023

Cost Of Risk Will Gradually Normalize From 2022 Onward



Banks' Cost Of Risk Benefitted From Longer Than Expected Forbearance



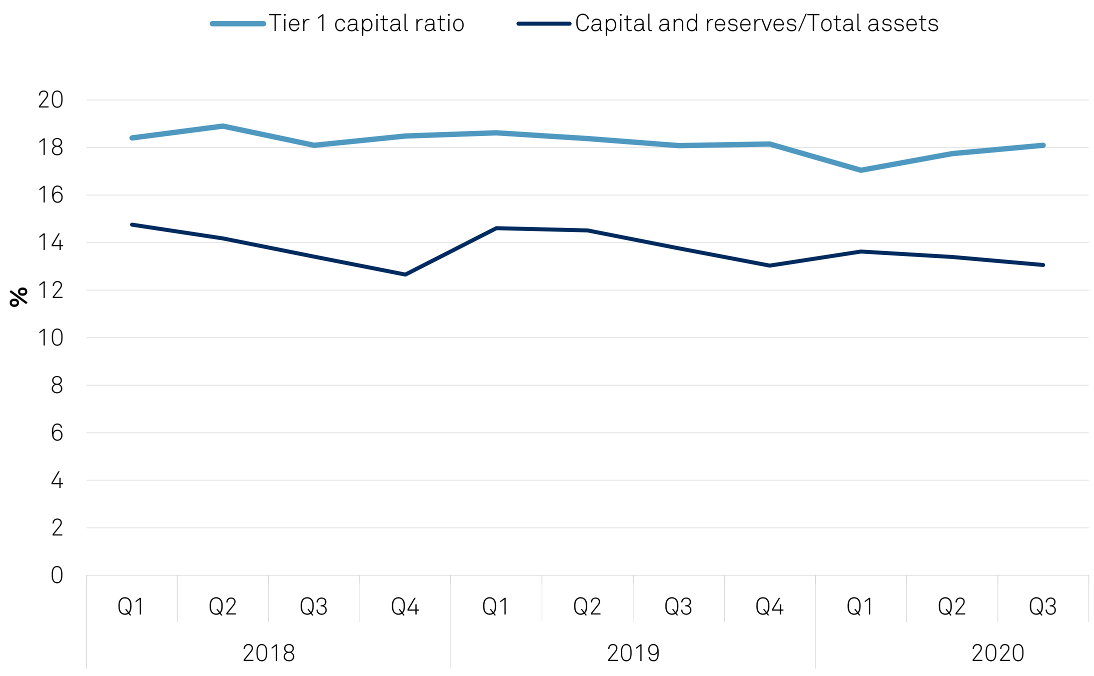
e--Estimated. f--Forecast. COR--Cost of risk. Q--Quarter. SME--Small and midsize enterprises. Weighted average guidance of NCB, ARB, SFG, BSF, and Riyad Bank. Source: S&P Global Ratings.

- We expect cost of risk to stay elevated in 2021 at about 120 basis points. This reflects our view that the volatile global health situation and international travel restrictions still weigh on the economy.
- Although the 2020 results seemed stronger-than-expected, we view this as a distortion caused by fast growth in mortgages across the year and lending to government-related entities in the first quarter of 2020.
- Additional provisions may be needed to offset the wind-down of SME support programs in 2021, including payment deferrals.

Capitalization Will Stay Strong Through 2021-2022

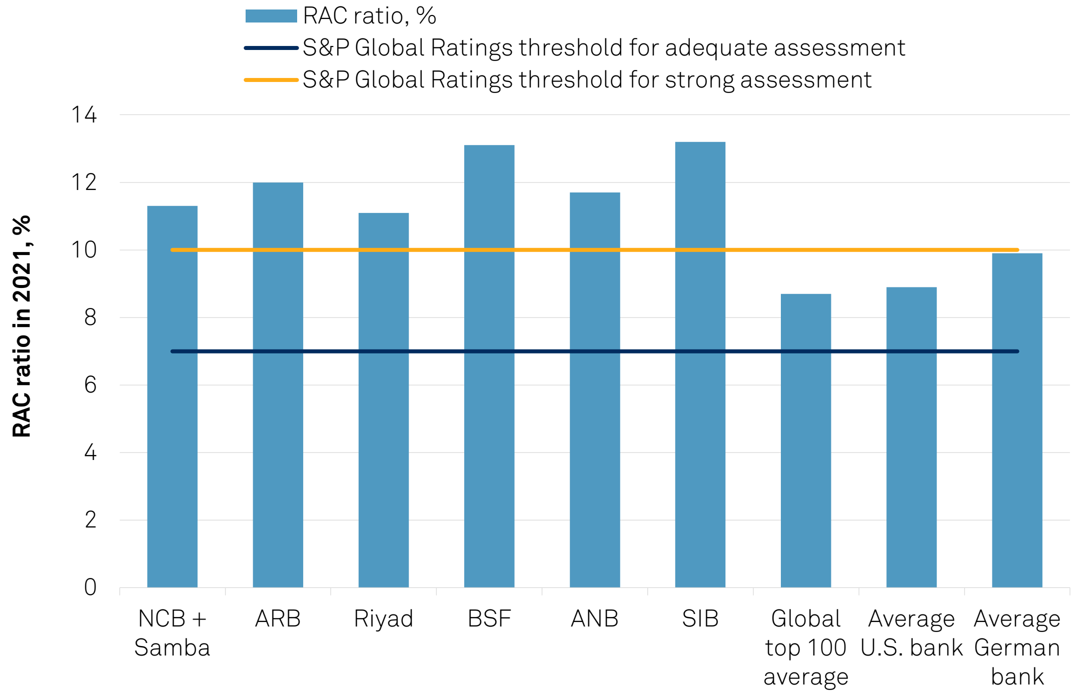
- Saudi banks are well-capitalized by international standards.
- We expect rated banks' capitalization to stay strong, as measured by our risk-adjusted capital ratio.

Capitalization Is Strong ...



Source: Saudi Central Bank.

... And We Expect It To Remain So



RAC--Risk-adjusted capital. Source: S&P Global Ratings.

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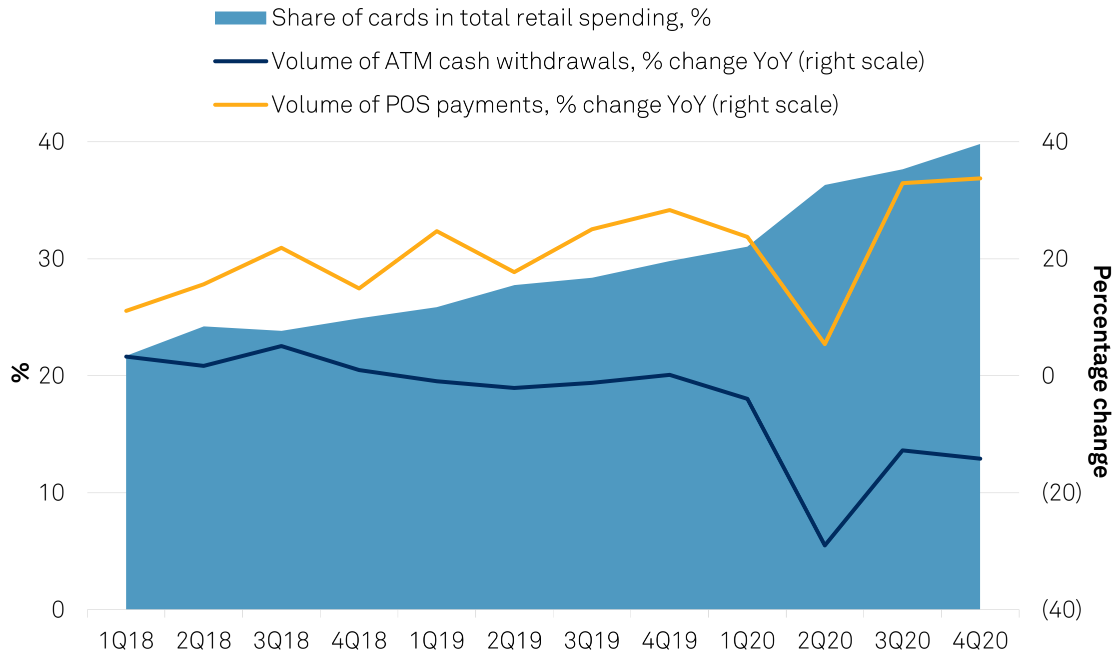
Saudis Are Withdrawing Less Cash

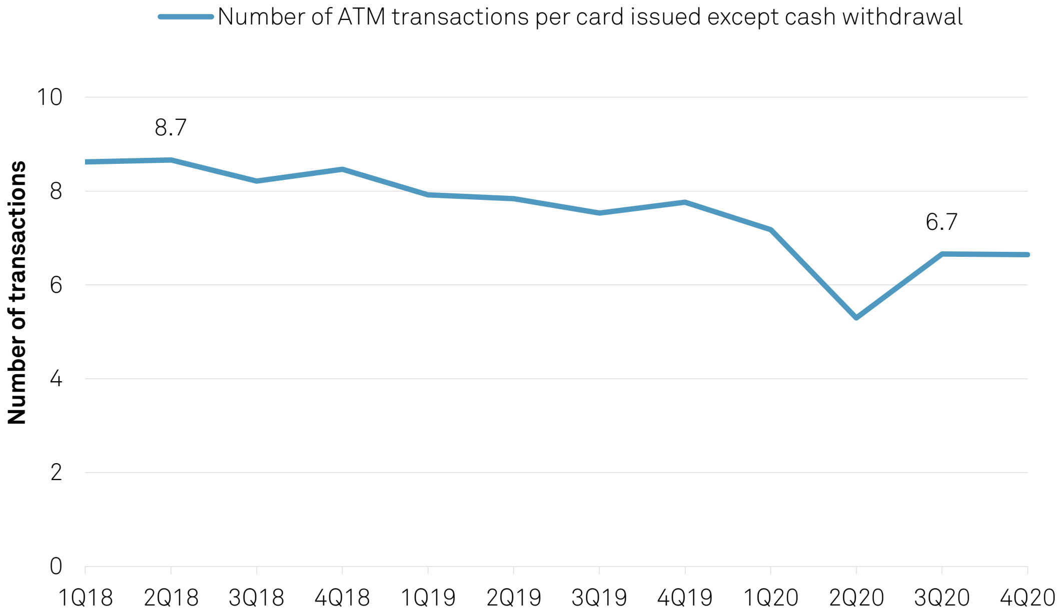
- Payment in cash has gradually become less prevalent in Saudi Arabia, demonstrating a growing digitalisation of the banking system. This exposes Saudi financial institutions to competition from challenger banks in the future.
- Banks face more competition in retail spaces because of open application programming interface (API) policies and the emergence of fintech companies. In particular, buy-now-pay-later cards and peer-to-peer lending are becoming popular.

ATM Cash Withdrawals Declined In Favor Of POS Payments



YoY--Year-on-year. POS—Point of sale. Q--Quarter. Source: S&P Global Ratings, Saudi Central Bank.

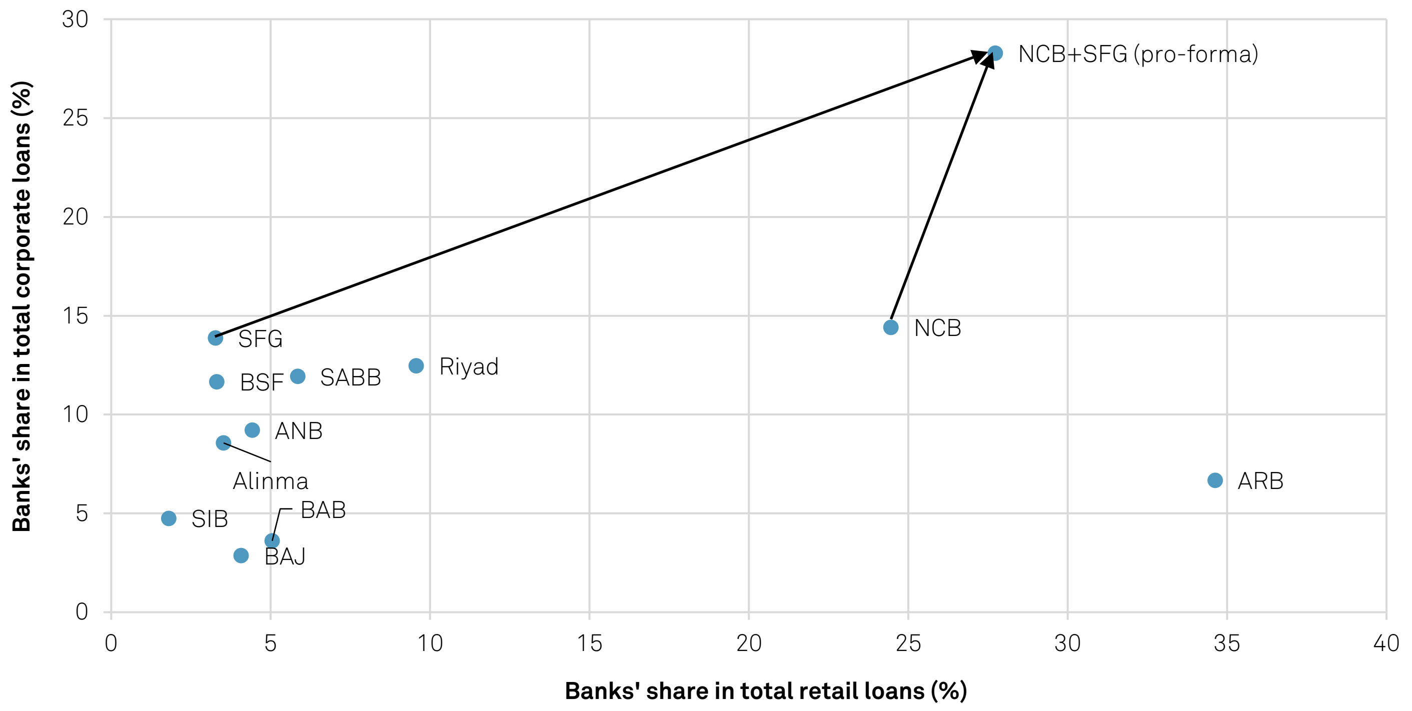
ATM Use For Noncash Transactions Has Also Fallen



Q--Quarter. Source: S&P Global Ratings, Saudi Central Bank.

NCB-SFG Merger Will Create A National Champion

Merger With SFG Will Double NCB's Corporate Market Share



Source: S&P Global Ratings based on banks' financial statements as of Sept. 30, 2020.

- Merger of NCB and SFG will sharply change the landscape in corporate lending, creating a player with pro forma market share of almost 30%.
- It is not yet clear to what extent the government will use the merged bank's balance sheet to finance strategic projects.
- Given that Al Rajhi Bank (ARB) already has a strong position in the retail segment, the increase in competition may dent the profitability of smaller players in the long term.

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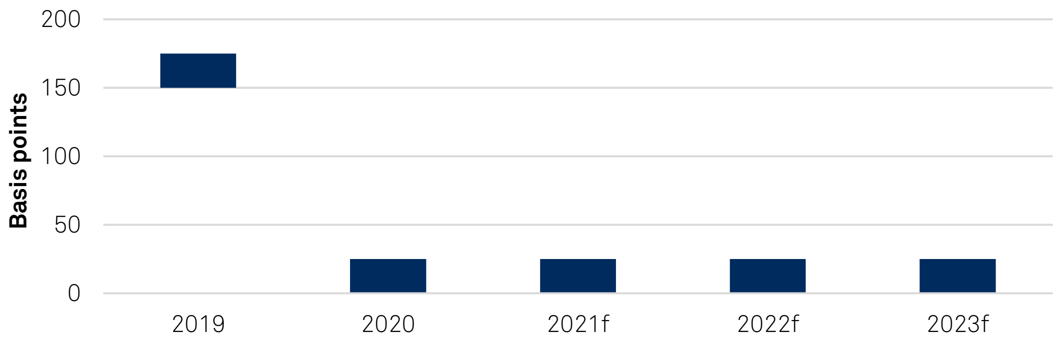
Low Interest Rates Eat Into Profitability

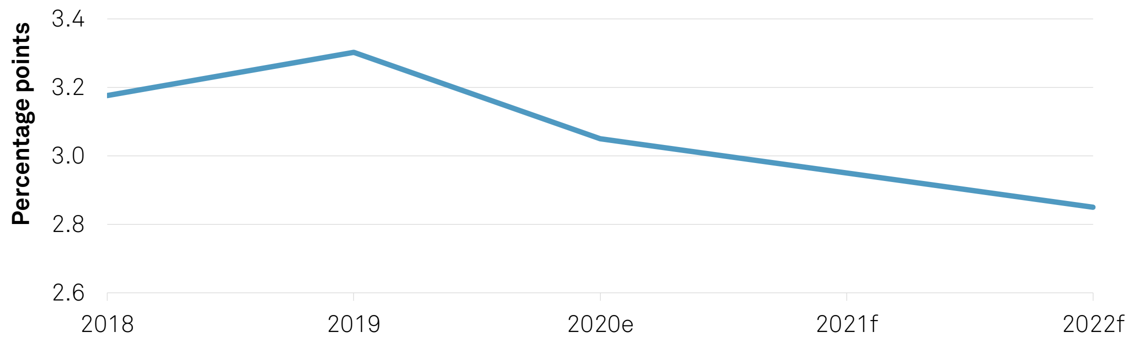
1. We Project That Interest Rates Will Stay Low For Longer...

Federal funds target rate



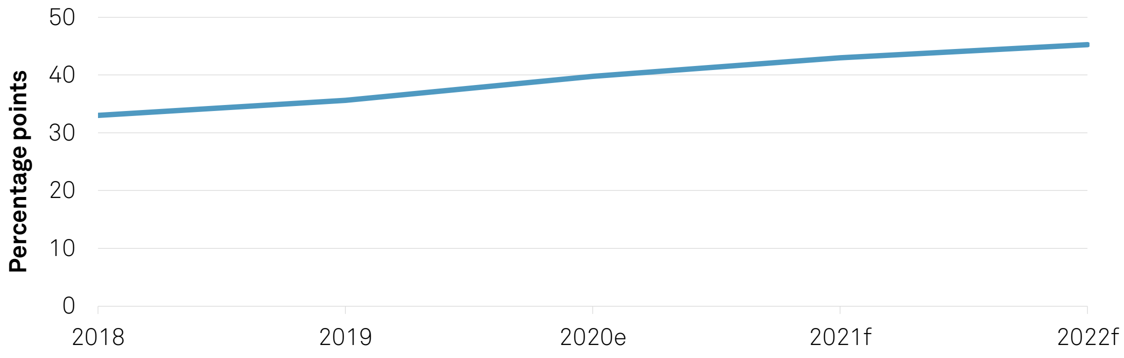
2. ... Which Would Weigh On Saudi Banks' Net Interest Margins...

Saudi banks' NIM



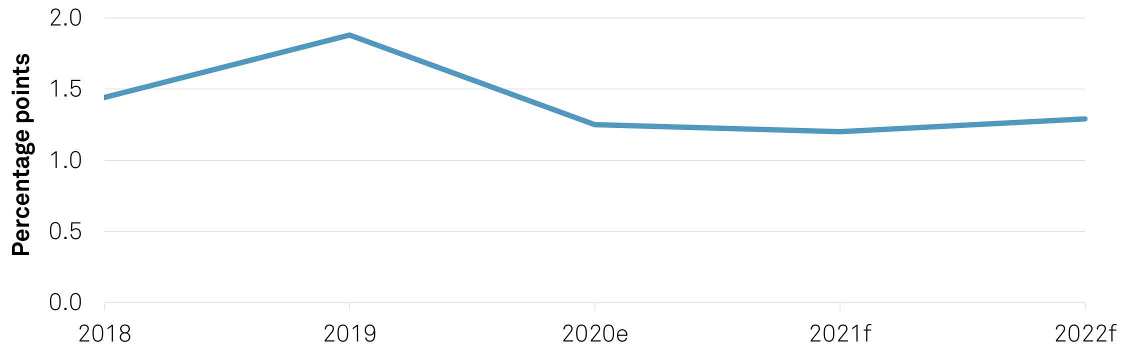
3. ... Despite Increasing Share Of Higher-Rate Retail Business...

Share of retail in total credit



4 ... Resulting In Lower Returns

Saudi banks' ROA

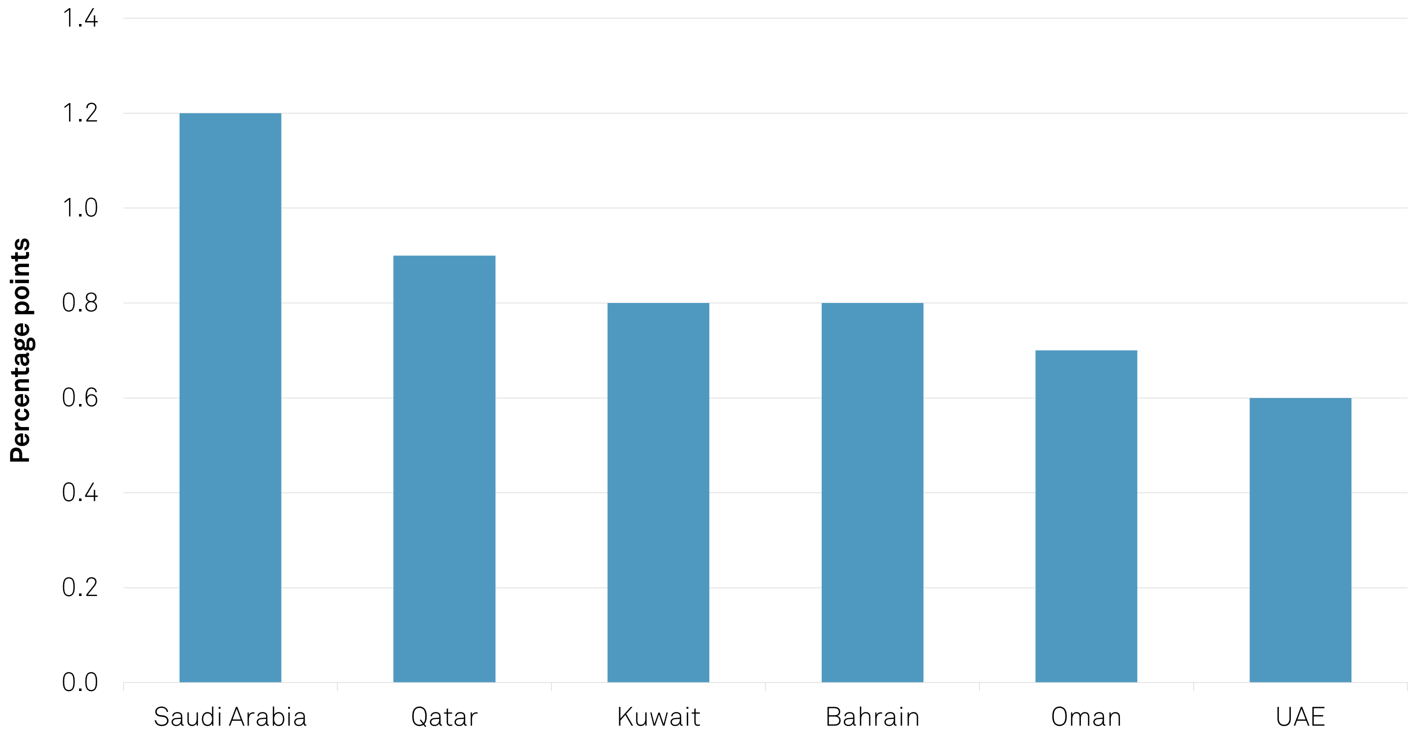


f--Forecast. NIM--Net interest margin. ROA--Return on assets. Source: S&P Global Ratings.

Profitability Still Outperforms Regional Peers

Saudi Arabian Banks Will Outperform Their Regional Peers

Projected return on assets for Gulf Cooperation Council banking systems in 2021



Source: S&P Global Ratings. UAE--United Arab Emirates.

- Despite the lower profitability, we anticipate that, on average, Saudi banks will outperform their regional peers.
- This largely reflects the relatively modest impact of the pandemic on the quality of banks' loan books and stronger growth of mortgage lending.

S&PGR Outlooks On Saudi Banks Are Mostly Stable

Our Outlooks On Saudi Banks Are Mostly Stable

Bank	SACP	Ratings
The National Commercial Bank	bbb+	BBB+/Positive/A-2
Samba Financial Group	bbb+	BBB+/Positive/A-2
Al Rajhi Bank	bbb+	BBB+/Stable/A-2
Riyad Bank	bbb+	BBB+/Stable/A-2
Banque Saudi Fransi	bbb	BBB+/Stable/A-2
Arab National Bank	bbb	BBB+/Stable/A-2
The Saudi Investment Bank	bbb-	BBB/Stable/A-3

SACP--Stand-alone credit profile. Source: S&P Global Ratings.

- Our outlooks on Saudi banks are mostly stable, indicating that we expect the size of the economy, conservative regulation, and lack of aggressive growth pre-2020 to help the banking sector navigate the challenges of 2021-2022.
- The positive outlooks on NCB and SFG signify that the post-merger institution may have a stronger credit profile than the individual banks.

Related Research

- GCC Economic Activity Held Back By Its Hydrocarbon-Heavy Economic Structure And OPEC-Related Production Cuts, Dec. 7, 2020
- Saudi Arabia-Based The National Commercial Bank And SAMBA Financial Group Outlooks Revised To Positive On Planned Merger, Oct. 16, 2020
- Banking Industry Country Risk Assessment: Saudi Arabia, Oct 13, 2020
- GCC Banks: Lower Profitability Is Here To Stay, Oct. 13, 2020
- Saudi Arabia 'A-/A-2' Ratings Affirmed; Outlook Stable, Sept. 25, 2020

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