Bank Audi

SAUDI ARABIA ECONOMIC REPORT

JUNE 2022

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AMID THE BENEFITS OF OIL PRICE SURGE, THE RECOVERY IN DOMESTIC DEMAND AND THE PROGRESS IN DIVERSIFICATION

Sound macro recovery underway

The Kingdom's economy is recovering at a fast pace. Saudi Arabia's real GDP is set to grow by 7.6% in 2022 as per IMF, against 3.2% in 2021. A major contributor to economic growth this year will be the oil sector, with the latter likely to grow at the fastest rate since 2003. It will expand by 14% as the country continues to reverse the 2020 oil production cuts pursuant to the current OPEC+ agreement. Economic growth will also be supported by the non-oil sector, which will benefit from the recovery in domestic demand and progress on the implementation of economic diversification projects.

Pick-up in annual inflation in 2022 on global supply disruptions and soaring energy prices

Saudi monetary conditions were marked by rising inflationary pressures early-2022 and declines in FX buffers, while the Saudi Central Bank increased its key policy rates in tandem with the US Federal Reserve's move, given the peg. In details, Saudi Arabia's annual inflation accelerated to 2.3% in April 2022, its highest level since June 2021, mainly due to global supply chain disruptions, and rising commodity and energy prices associated with Russia's invasion to Ukraine.

Robust balance of payments on the back of a surplus in current account

Following the robust COVID-19 pandemic recovery and its economic implications, and the soaring oil prices and rising production volumes, Saudi Arabia witnessed a surplus in its external position in 2021 (after its deterioration in 2020) and higher than its level in 2019. In fact, the current account balance of 2021 witnessed a surplus for US$ 44.3 billion, against a deficit for US$ 22.8 billion in 2020. This is mainly attributed to a higher trade balance in 2021 representing an increase of 184.6% when compared to its level in year 2020.

A firmly growing banking industry activity amid good financial soundness

Banking activity remained sound and growing. Measured by total assets of banks operating in the Kingdom, banking activity grew by 10.0% in 2021 and by 3.4% in the first four months of 2022, with assets to GDP recording 86.9% at end-April. Likewise, deposits grew by 8.3% in 2021 and by 3.7% in the first four months of 2022. Loan growth was the most vigorous, registering 15.3% in 2021 and 5.9% in the first four months of 2022, with total loans almost reaching total deposits in April. Capital adequacy remained sound, with an equity to assets ratio of 14.1%. As to profitability, the annualized return on average assets recorded 1.97% this year, while the annualized return on average equity recorded 13.8%, representing sound profit ratios for operating banks at large.

Saudi equities extend winning streak on soaring oil prices, bonds dip further into red amid global sell-off mood

Saudi equities extended their winning streak over the first five months of 2022, mainly helped by robust oil price gains and restrictive global monetary policy, while Saudi debt papers dipped further into the red, tracking US Treasuries move after the US Federal Reserve embarked into an aggressive monetary policy tightening to rein in 40-year high inflation. The Saudi Exchange registered double-digit price gains over the first five months of 2022, as reflected by a 14.5% surge in the Tadawul All-Share Index to reach 12,921.74 at end-May, following a strong price rally of 29.8% in 2021. As to the cost of insuring debt, Saudi Arabia's five-year CDS spreads, which measure the market's perception of sovereign risks, expanded by 14 bps during the first five months of 2022 to reach 63 bps at end-May, staying well below the average regional sovereign five-year CDS spreads of 235 bps.

Amid the benefits of oil price surge, the recovery in domestic demand and the progress in diversification

Higher global oil prices and rising production volumes, alongside a recovery from the COVID-19 pandemic, are supporting Saudi Arabia's fiscal and GDP growth dynamics, as well as its already strong external metrics. Real GDP growth will average around 3.0% over the next five years as per new IMF forecasts (within the recently released World Economic Outlook), a stronger trend than in the years running up to the pandemic. Looking forward, the structural diversification of the economy away from oil and upstream hydrocarbons Is set to continue, with the non-oil private sector accounting for over 50% of GDP, significantly higher than a decade ago.

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The Kingdom's economy is recovering at a fast pace. Saudi Arabia's real GDP is set to grow by 7.6% in 2022 as per IMF, against 3.2% in 2021. A major contributor to economic growth this year will be the oil sector, with the latter likely to grow at the fastest rate since 2003. It will expand by 14% as the country continues to reverse the 2020 oil production cuts pursuant to the current OPEC+ agreement. Economic growth will also be supported by the non-oil sector, which will benefit from the recovery in domestic demand and progress on the implementation of economic diversification projects. Oil GDP accounts for around a third of nominal GDP and non-oil sector performance is linked in part to oil-funded investment.

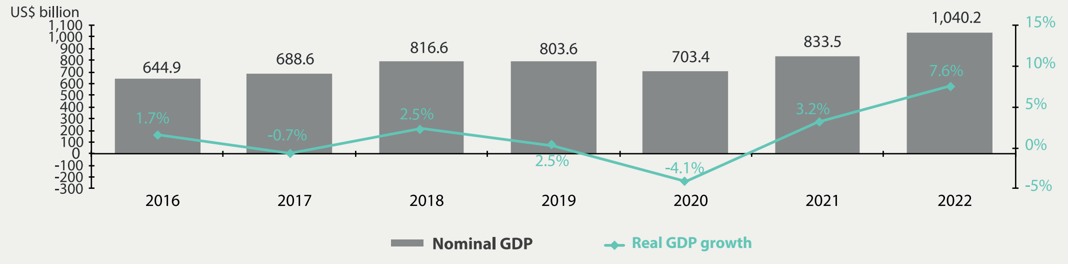
At the external level, the Kingdom is seeing increased surpluses in its current account balances that could approximate 20% of GDP this year. The improvement in the external position is tied to the rise in oil prices over the past couple of years that yielded significant external oil revenues to the country's at large. Saudi Central Bank has a track record of having maintained significant reserve coverage and has managed external assets in a conservative manner. Gross foreign-exchange reserves stood at US$ 452 billion at end-April 2022 (80.3% of local currency Money Supply). The country maintains a net external asset position of 115% of current account payments in 2022-2025. This represents a sizable amount of over 15 months of current account payment cover.

At the fiscal level, a tangible improvement is being recorded, with fiscal balance to GDP moving from a deficit of -2.5% in 2021 to a surplus of 5.5% of GDP in 2022, according to the IMF. While Saudi Arabia's fiscal structure has improved, oil revenue will account for more than 60% of total budget revenue (down from 90% ten years ago) and more than 70% of export revenue. Gradual improvements in the fiscal structure, with the non-oil primary deficit/non-oil GDP narrowing to 27% of GDP (50% before 2015) and the fiscal break-even oil price falling to less than US$ 70/bbl from around US$ 80/bbl on average in 2019-2021.

At the monetary level, inflation is on an upward pace, along with global trends generated by the post-pandemic recovery and the Russian-Ukrainian war spillover effects. The Kingdom's CPI moved from 1.2% in 2021 to 2.3% by April 2022. The peg has historically helped anchor inflation expectations and has upheld the predictability of Saudi Arabia's monetary arrangements, especially at times of volatile oil prices. Interest rates broadly move in tandem with the U.S. Federal Reserve rates, given the peg. In response to the pandemic's economic fallout, Saudi Central Bank cut its main policy rate to a record low of 1% in April 2020 (negative in real terms), and then followed the U.S. Federal Reserve's move since March 2022 and raised its repo and reverse-repo rates the same month.

At the banking level, activity remained sound and growing. Measured by total assets of banks operating in the Kingdom, banking activity grew by 10.0% in 2021 and by 3.4% in the first four months of 2022, with assets to GDP recording 86.9% at end-April. Likewise, deposits grew by 8.3% in 2021 and by 3.7% in the first four months of 2022. Loan growth was the most vigorous, registering 15.3% in 2021 and 5.9% in the first

NOMINAL AND REAL GDP



Sources: Saudi Central Bank, IMF, Bank Audi's Group Research Department

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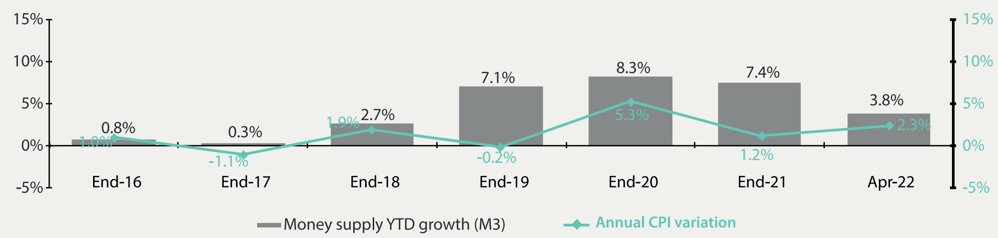
four months of 2022, with total loans almost reaching total deposits in April. Capital adequacy remained sound, with an equity to assets ratio of 14.1%. As to profitability, the annualized return on average assets recorded 1.97% this year, while the annualized return on average equity recorded 13.8%, representing sound profit ratios for operating banks at large.

At the capital markets level, activity was at the mirror image of a recovering economy. The share price index surged by 29.8% in 2021 and by 14.5% in the first five months of 2022. Subsequently, market capitalization moved from US$ 2,427 million at end-2020 to US$ 2,669 million at end-2021 and to US$ 3,324 million at end-May 2022. The rise in prices comes within the context of stronger trading activity. Total trading value rose from US$ 557 million in 2020 to US$ 596 million in 2021 (US$ 238 million in the first five months of 2022). With respect to fixed income markets, the 5-year CDS spread, a measure of market perception of sovereign risks, moved from 65 basis points at end-2020 to 49 basis points at end-2021 and to 63 basis points at end-May 2022.

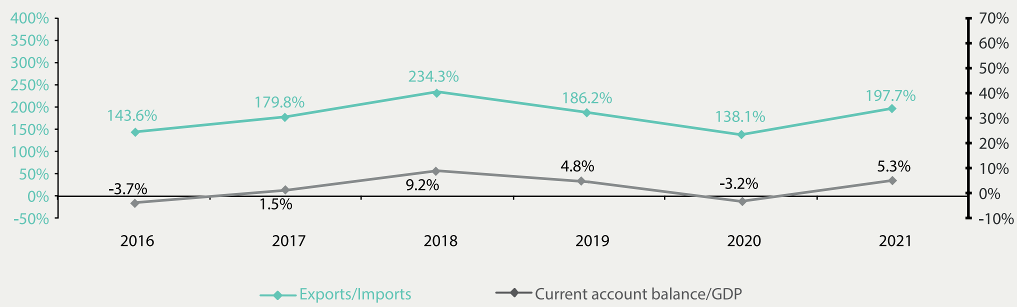
The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address Saudi Arabia's middle to long term economic outlook looking forward.

MONEY SUPPLY AND INFLATION



Sources: Saudi Central Bank, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Hydrocarbon sector

Hydrocarbon sector's profitability up on the back of rising prices and demand growth

Strong oil production growth and a sturdy recovery in the non-oil sector is expected to drive 2022 growth in Saudi Arabia. Profitability is rising across the industry on rising prices and demand growth.

At the upstream level, Saudi Aramco continues its expansionary phase and directed investments in its upstream segment that include exploration, developing and producing crude oil, condensate, natural gas and NGL. At the level of projects, the recently awarded Jafurah contracts include subsurface and Engineering, Procurement and Construction (EPC) contracts worth US$ 10 billion.

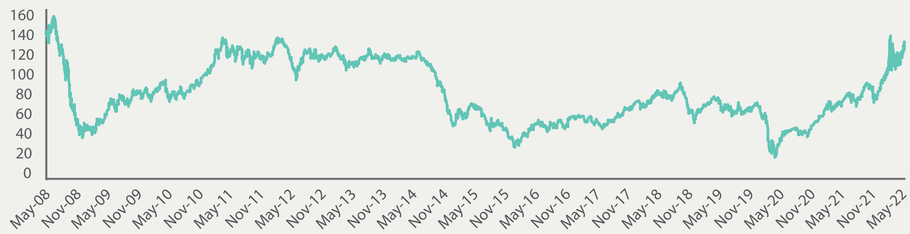
At the level of downstream, Aramco has an integrated global downstream business, primarily consisting of refining and petrochemical manufacturing, supply and trading, distribution and power generation. Other activities such as base oils, lubricant and retail operations also fall under this category. It is noteworthy that Aramco's downstream investments are a source of revenue diversification through integrating its oil and gas operations to optimize value across the hydrocarbon chain, supporting crude oil and gas demand and facilitating the placement of its crude oil.

Robust price growth aided Saudi producers to maintain their margins from the impact of rising raw material to supply or fuel a machine or industrial process costs on the back of energy price growth. Producers were able to secure strong and growing profits through 2021 as demand picked up and supply bottlenecks tightened the market.

It is worth noting that the takeover of 70% of SABIC by Aramco has created synergies, improving opportunities for maintaining margins even as prices soften in the event of slackening demand or a further rise in costs, as per Fitch Solutions.

High levels of competitiveness and a more diverse raw material slate ensured that the powerful growth in Saudi petrochemicals output and improving margins in 2021, but margins in Q122 were more under pressure in some segments as demand growth moderated and energy prices ascended, as per the same source.

CRUDE OIL PRICES



Sources: Bloomberg, Bank Audi's Group Research Department

Despite the impact of the COVID-19 pandemic, the Saudi Arabian petrochemicals industry is confident of long-term mount in exports.

In conclusion, the hydrocarbons industry still captures a competitive advantage due to economies of scale and the high level of integration between upstream energy sources and value chains. In 2022, margins are expected to moderate and raw material to supply or fuel a machine or industrial process costs remain high while existing supply constraints ease and new supply capacity comes on line.

1.1.2. Non-Hydrocarbon Sector

Positive outlook reported for Saudi Arabia's non-hydrocarbon sector

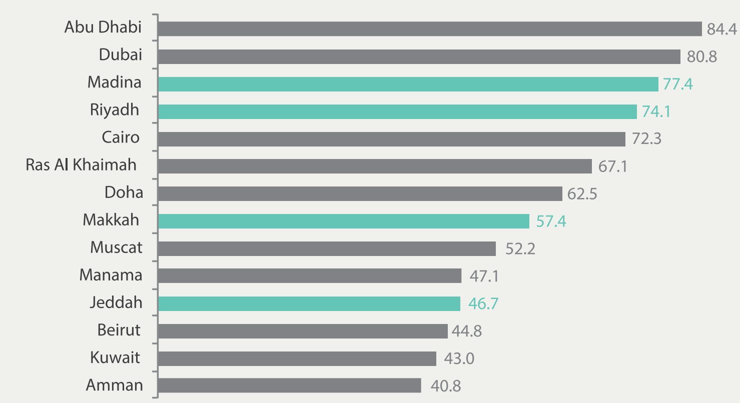
Non-oil activity is benefitting from strong private consumption growth and capital spending, partly because of the impact of higher oil prices on government revenue and the broader economy.

In details, looking at the performance of the real estate sector, the latter was mixed last year across the four major markets in the Kingdom. Overall, Makkah and Dammam metropolitan area's real estate sectors remained pressured. Conversely, Riyadh fared better. The capital's limited availability of good quality office space coupled with strong demand – mainly from international firms – underpinned the 4% uplift in office rents in Q4 2021, as per Jones Lang Lasalle (JLL). At the level of the residential sector, Riyadh's growing workforce and population helped provide a boost to residential sales prices, which rose by 6% year-on-year in the final quarter. On another level, the vast majority of new office supply delivered last year was in Riyadh. Challenging economic conditions due to the pandemic pushed some developers to adopt a wait-and-see approach by temporarily halting work on projects, as per the same source.

At the level of consumption, real household spending in Saudi Arabia is expected to grow 3.7% in 2022, as per Fitch Solutions. While this remains notably lower than the 7.5% growth estimated in 2021, the slowdown is largely due to the unfavorable base effects wearing off. Consumer spending growth will begin to moderate throughout 2022, as the Saudi consumer sector's complete recovery from the worst effects of the Covid-19 pandemic emerges, as per the same source.

Looking at the tourism sector, an overall positive outlook for the sector arises as authorities continue to implement an aggressive recovery strategy backed by a stream of multibillion dollar investments and tourism-friendly policies. According to Ernst & Young, as of Q1 2022, Jeddah's hospitality sector witnessed a RevPAR drop of 3.0% from US$ 94 in Q1 2021 to US$ 91. Despite rise in occupancy by 1.7 percentage points, the drop in ADR by 6.6% from US$ 208 in Q1 2021 to US$ 194 in Q1 2022 resulted in the RevPAR drop. Makkah's hospitality market experienced an occupancy rise of 40 percentage points from 17.4% in Q1 2021 to 57.4% in Q1 2022 which resulted into a RevPAR increase of 191.3% during the same period. However, ADR decreased year-on-year by 11.8% from US$ 113 in Q1 2021 to US$ 100 in Q1 2022. Occupancy rates in

COMPARATIVE HOTEL OCCUPANCY RATES (%)*



** First quarter of 2022*

Sources: Ernst & Young, Bank Audi's Group Research Department

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Riyadh expanded from 48% in the first quarter of 2021 to 74.1% in the corresponding period of this year. Similarly, that of Madina increased from 37.1% to 77.4% over the same period.

In sum, indicators pointed to Saudi Arabia's non-oil economy recovering from the COVID-19 pandemic. The Saudi government continues its investment and diversification strategy that aims to transform the country into a global logistics and freight hub at large.

1.2. EXTERNAL SECTOR

Robust BOP in 2021 on the back of a surplus in current account

Following the robust COVID-19 pandemic recovery, and its economic implications, and the soaring oil prices and rising production volumes, Saudi Arabia witnessed a surplus in its external position in 2021 (after its deterioration in 2020) and higher than its level in 2019. In fact, the current account balance of 2021 witnessed a surplus for US$ 44.3 billion, against a deficit for US$ 22.8 billion in 2020. This is mainly attributed to a higher trade balance in 2021 representing an increase of 184.6% when compared to its level in year 2020, as the oil exports in 2021 constituted 73.2% of total exports. It is worth noting that the current account improved sharply in 2021 to 5.3% of GDP in 2021 as per S&P, exceeding previous estimations.

Saudi Arabia's foreign trade figures as disclosed by Saudi Central Bank revealed a significant increase in exports by 58.9% alongside a 11.0% rise in imports in 2021. Saudi's foreign trade surplus went up from US$ 47.9 billion in 2020 to US$ 136.5 billion in 2021 or a rise of 184.6% (year-on-year). This is mainly due to growth in exports of oils and mineral products where Saudi Arabia is highly dependent on.

In details, total exports reached a total of US$ 276.2 billion in 2021 up from US$ 173.9 billion in 2020. The breakdown of exports by category, according to Saudi Central Bank, explains that exports of mineral products, grabbing the lion's share of total exports with 73.6% of total exports, were followed by exports of plastic products representing 8.8% of total exports and exports of Chemical products constituting 8.0% of total exports over the same period. The geographical distribution of exports during same period indicates that 18.4% of total exports went to the China, followed by the European Union with 10.5% and Gulf Corporation Council with 9.3% of the totals for year 2021.

At the level of imports, a total of US$ 139.7 billion was registered in 2021, compared to US$ 125.9 billion in 2020, marking an optimistic local demand post pandemic and economic recovery after the vaccination momentum. The breakdown of imports by category suggests that imports of machinery and transport equipment posted the highest share of 35.0% of total imports, followed by chemicals and related products with 10.6%, base metals with 9.4%, vegetables and live animals with a share of 6.9%, prepared foodstuffs and mineral products with 5.1% each of total imports over the year 2021. The breakdown of imports by geographical distribution shows that most of the inward merchandise came from the European Union with 23.4% of the totals, followed by China with 19.8%, followed by Gulf Corporation Council with 11.5% and USA with 10.6% of the total over year 2021.

On the other side of the external sector, the latest available figures by Saudi Central Bank showed that the financial account recorded a big shift from a deficit of US$ 24.1 billion in 2020 up to a surplus of US$ 41.6 billion in 2021. This was mainly due a significant increase in portfolio investment inflows which exhibited a 62.7% hike year-on-year in 2021 reaching US$ 38.5 billion, in addition to the good reserve assets management that reported a surplus of US$ 1.7 billion in 2021, from a deficit of US$ 45.9 billion in 2020.

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1.3. PUBLIC SECTOR

Government fiscal position witnessing a surplus for the first time since 2013

Fiscal performance in Saudi Arabia is improving on the back of the global economy rebound tied to the kingdom's emergence from the Coronavirus pandemic, ongoing structural reforms and surging global oil prices, demand and production unlike its previous dynamics during year 2020. In this context, it is worth highlighting that the government fiscal position is set to return to surplus for the first time since 2013.

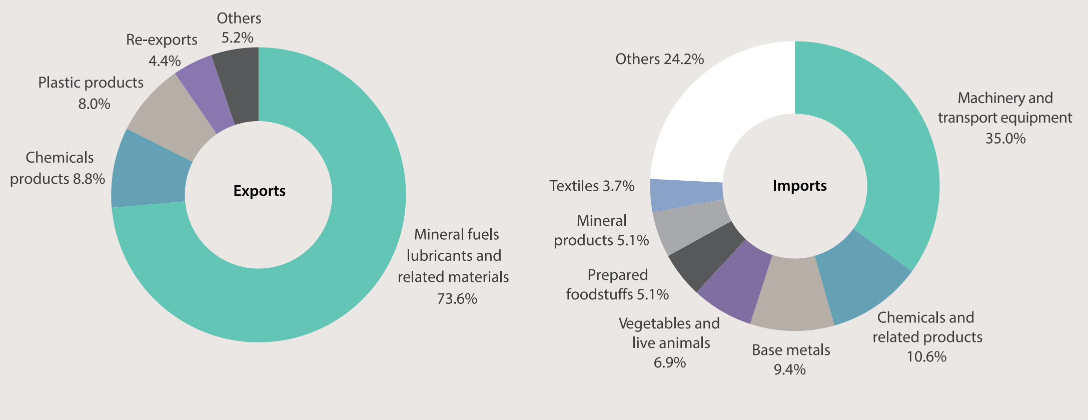
Total public revenues are forecast to reach SAR 1,045 billion in budget 2022, on the back of the global and domestic economic recovery and higher oil prices (with oil output set to rise at least 14% as per S&P, while prices rise 20%) in addition to the Ukranian-Russsian conflict. Tax revenues are expected to represent 27% of total revenues in 2022; VAT is 15% up from 5%. The oil revenues, combined with fiscal prudence, are consistent with the fiscal sustainability program that would improve public finances. It is worth mentioning that revenues jumped in 2021 by almost 10% to SAR 930 billion riyals (US$ 247.9 billion) from the budgeted SAR 849 billion (US$ 226.3 billion), driven by higher crude prices and oil production hikes as global energy demand recovered.

The 2022 budget also envisages a cut in expenditure of 6% compared to 2021 levels, on the back of Saudi Arabia's plan to spend SAR 955 billion (US$ 254.6 billion), according to a budget document. Moreover, it plans to reduce military spending by about 10% from its 2021 estimates, the budget showed. The kingdom continues its focus and commitment to spending on education, healthcare and social development, as part of its mission to fulfil Vision 2030 objectives. It is worth noting that during the recovery phase of the pandemic, the ministry of finance pledged its commitment to fiscal carefulness; higher spending by the broader public sector to support economic growth and job creation.

As such, budget 2022 estimates a general government budget surplus of 2.5% of GDP, contributing to surplus of around SAR 90 billion (US$ 24.0 billion). It is expected that public debt will stand at SAR 938 billion in 2022, or 25.9% of GDP.

Looking forward, the VAT rate increase, the higher oil prices and production, the expiration of Coronavirus-related spending, the government continued reforms to improve spending efficiency and achieve fiscal discipline, as well as continuing with transferring the investment burden to the state funds led by PIF are expected to help growing the Kingdom's fiscal surplus at large.

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY 2021



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Pick-up in annual inflation in 2022 on global supply disruptions and soaring energy prices

Saudi monetary conditions were marked by rising inflationary pressures early-2022 and declines in FX buffers, while the Saudi Central Bank increased its key policy rates in tandem with the US Federal Reserve's move, given the peg.

In details, Saudi Arabia's annual inflation accelerated to 2.3% in April 2022, its highest level since June 2021, mainly due to global supply chain disruptions, and rising commodity and energy prices associated with Russia's invasion to Ukraine.

The breakdown of the cost of living index by segment during the first four months of 2022 shows that the education segment registered the largest yearly expansion in April 2022 of 6.2%, followed by the transportation segment with +4.6% (weight of 13.1%) amid soaring Brent oil prices, the food and beverages segment with +4.3% (with a weight of 18.8%), the restaurants and hotels segment with +3.2%, the miscellaneous goods and services segment with +2.8%, the recreation and culture segment with +2.8%, the furnishings & household equipment segment with +1.4% and the housing, water, electricity, gas, and other fuels segment with +0.2%. In contrast, the clothing and footwear segment registered the largest year-on-year contraction of 0.7%, followed by the tobacco segment with -0.5% and the communication segment with -0.1%.

Given the Saudi riyal peg to the US dollar at SR/US$ 3.75 and in line with the Saudi Central Bank's objective of maintaining monetary and financial stability, the Bank followed in March, May and June 2022 the lead taken by the US Federal Reserve in tightening its monetary policy to tame inflation at multi-decade highs, rising its repo and reverse repo rates by a total 125 bps each to reach 2.25% and 1.75% respectively.

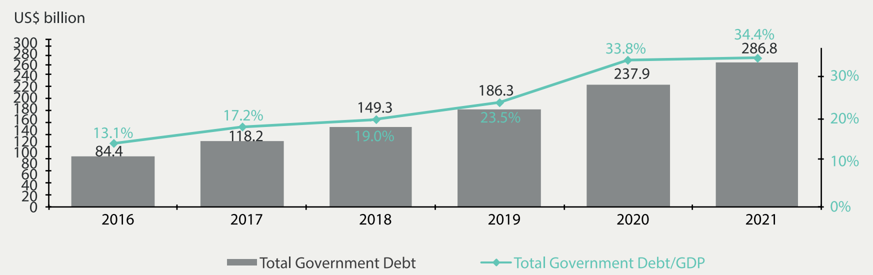
In parallel, the Saudi Central Bank's reverse assets contracted by US$ 3.7 billion during the first four months of the year 2022, following a US$ 1.7 billion rise in 2021, reaching US$ 451.7 billion at end-April 2022. This is mainly explained by a US$ 4.9 billion drop in "investment in foreign securities" over the first four months of 2022, with no new issues taking place this year amid forecasts that the Kingdom would post this year its first fiscal surplus since 2013 on the back of elevated oil prices, rising crude production volumes and a tightening

SAUDI ARABIA'S BUDGET

(SR billion)	2017A	2018A	2019A	2020A	2021E	2022P
Total revenue	692	906	927	782	930	1,045
Oil revenue	436	611	594	413	558	-
Non-oil revenue	256	294	332	369	372	-
Expenditure	930	1,079	1,059	1,076	1,015	955
Budget balance	-238	-173	-133	-294	-85	90
Gross public debt	443	560	678	854	938	938

Sources: IMF, Ministry of Finance, Bank Audi's Group Research

PUBLIC INDEBTEDNESS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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of spending. The fall in "investment in foreign securities" over the first four months of 2022 is compounded with a US$ 811 million contraction in SDR and a US$ 2.0 billion rise in "foreign currency and deposits abroad".

Regarding monetary aggregates, the narrow measure of money supply (M1) grew by 0.9% during the first four months of 2022, reaching US$ 421 billion at end-April, given a 4.8% rise in "circulation outside banks" and a 0.3% increase in "demand deposits". This followed a 5.1% expansion in (M1) in 2021. The broader money supply (M2), which grew by 4.9% in 2021, widened by 2.4% during the first four months of 2022 (the equivalent of US$ 13.0 billion) to reach US$ 562 billion amid a 7.1% increase in time and saving deposits. The money supply in its broadest sense (M3) expanded by 3.8% during the first four months of 2022 (the equivalent of US$ 23.3 billion), within the context of a significant rise in quasi-money deposits of 15.4%. This followed a 7.4% expansion in (M3) in 2021. Given a lower growth in demand deposits than money supply (M3) during the first four months of 2022, the demand deposits to broader money supply (M3) ratio reached 56.9% at end-April 2022, down from 58.9% at end-December 2021. In parallel, the M1/M3 ratio was quoted at 65.9% at end-April 2022, moving down from 67.8% at end-December 2021.

In the coming period, the IMF expects inflation in Saudi Arabia to average 2.5% in 2022 (down from 3.1% in 2021) amid global supply bottlenecks and surging oil prices and after the effects of the July-2020 VAT hike dropped out of the annual price comparison. Concomitantly, the Saudi Central Bank's monetary policy is set to remain anchored to the US Federal Reserve given the Saudi riyal peg to the US dollar.

1.4.2. Banking Activity

A firmly growing industry activity amid good financial soundness

Banking activity remained sound and growing. Measured by total assets of banks operating in the Kingdom, banking activity grew by 10.0% in 2021 and by 3.4% in the first four months of 2022, with assets to GDP recording 86.9% at end-April. Likewise, deposits grew by 8.3% in 2021 and by 3.7% in the first four months of 2022. Loan growth was the most vigorous, registering 15.3% in 2021 and 5.9% in the first four months of 2022, with total loans almost reaching total deposits in April. Capital adequacy remained sound, with an equity to assets ratio of 14.1%. As to profitability, the annualized return on average assets recorded 1.97% this year, while the annualized return on average equity recorded 13.8%, representing sound profit ratios for operating banks at large.

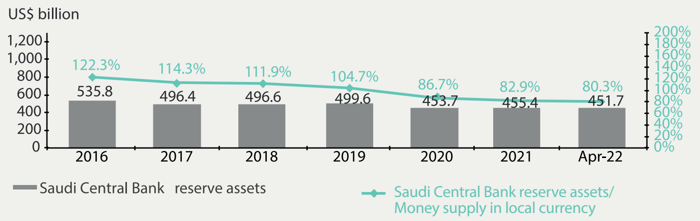
Interest rates have been on an upward trend this year. The average 3-month SR deposit rate, which contracted from 1.19% at end-2020 to 0.81% at end-2021, increased to 2.37% at end-April 2022. Likewise, the average 3-month deposit rate, which went down from 0.65% at end-2020 to 0.16% at end-2021 rose to 1.10% at end-April 2022. The rise in domestic rates is in line with the rising trend of international rates that materialized this year.

EVOLUTION OF MONETARY SITUATION

Flows in US$ million	2016	2017	2018	2019	2020	2021	Apr-22
Net foreign assets	**-102,915**	**-38,343**	**-5,207**	**-8,977**	**-45,543**	**-21,163**	**-1,412**
Saudi Central Bank	-80,276	-39,731	670	4,469	-44,882	-10,989	-2,709
Commercial Banks	-22,639	1,389	-5,877	-13,446	-661	-10,174	1,297
Domestic Assets	**37,779**	**16,508**	**24,158**	**50,044**	**76,835**	**87,984**	**31,079**
Claims on private sector	8,817	-3,389	10,678	27,005	57,579	72,439	31,610
Claims on public sector	24,602	20,301	13,496	20,938	14,586	11,301	-972
Claims on Nonfinancial Public sector Enterprises	4,360	-403	-15	2,102	4,670	4,244	441
Total Money (M3)	**3,767**	**1,457**	**12,926**	**35,065**	**43,767**	**42,547**	**23,265**
Money Supply (M1)	-595	7,495	12,342	18,004	53,484	20,160	3,628
Quasi-Money	4,362	-6,038	584	17,061	-9,716	22,388	19,637
Government Deposits	**-76,559**	**-36,722**	**-14,993**	**-15,613**	**-10,111**	**-12,617**	**8,046**
Other Items (Net)	**7,656**	**13,430**	**21,018**	**21,614**	**-2,364**	**36,891**	**-1,644**

Sources: Saudi Central Bank, Bank Audi's Group Research Department

FOREIGN EXCHANGE MARKET INDICATORS



Sources: Saudi Central Bank, Bank Audi's Group Research Department

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In a recent banking sector report, S&P said that it expects risks to the stability of Saudi Arabia's banking system to remain contained, despite rapid expansion over the next 12-24 months. Domestic credit growth will likely stay strong in 2022-2023 following the sharp 15% increase in 2021. They expect government's efforts to meet its Vision 2030 targets and strong demand for housing from Saudi nationals will support loan growth. Over the next few years, they forecast total credit growth at 10%-12%. Under its base-case scenario, S&P expects domestic private-sector credit to reach 90%-95% of GDP in 2022-2023 versus 68.8% in 2019. They expect the cost of risk to stabilize close to pre-COVID-19 levels after declining in 2021. Higher write offs and buoyant lending growth helped to reduce the nonperforming loan ratio. They expect it to remain stable because they anticipate growth will remain strong and banks will continue writing off loans when appropriate.

The Saudi banking sector is subject to adequate regulation under the supervision of the Saudi Central Bank (SAMA). Saudi Central Bank has consistently encouraged banks to proactively build strong loan loss provision buffers and has been instrumental in helping banks manage volatility in less favorable liquidity conditions over the past two years. Saudi banks benefit from a low-cost and stable core deposit base, with limited reliance on external debt. Low cost of funds and better-than-average cost of risk have supported the banking sector's profitability.

The sector's profitability is not likely to be challenged by recent competitive developments, such as the licensing of three online banks, approval for a telecommunications company to convert its payments business into a digital bank, or the opening of branches of foreign banks in Saudi Arabia. This is because Vision 2030 has created sufficient room for the sector's growth; bank customers, particularly corporate entities, continue to show a preference for traditional banking; and the telecom's focus is on a market niche. Banks' healthy funding and liquidity profiles are continued to be seen as a key differentiator compared with most other banking systems in the region and globally. It remains to be seen whether challenger banks will stoke competition on the funding side and accelerate the migration of deposits to remunerated instruments.

The overall trend for industry risk is viewed as stable. Banks are expected to maintain high levels of core deposits in their funding bases and that their strong liquidity metrics will remain intact. Banks' margins should benefit from higher rates, although S&P foresees increasing competition from neobanks and foreign banks' branches at large.

1.4.3. Equity and Bond Markets

Saudi equities extend winning streak on soaring oil prices, bonds dip further into red amid global sell-off mood

Saudi equities extended their winning streak over the first five months of 2022, mainly helped by robust oil price gains and restrictive global monetary policy, while Saudi debt papers dipped further into the red, tracking US Treasuries move after the US Federal Reserve embarked into an aggressive monetary policy tightening to rein in 40-year high inflation.

The Saudi Exchange registered double-digit price gains over the first five months of 2022, as reflected by a 14.5% surge in the Tadawul All-Share Index to reach 12,921.74 at end-May, following a strong price rally of 29.8% in 2021. This is mainly driven by: 1) soaring oil prices as Brent prices surged by 53.5% over the first five months of 2022, topping the US$ 115 per barrel level at end-May due to global supply chain disruptions associated with Russia's invasion of Ukraine and on prospects of higher demand for oil during the US summer driving season; 2) upbeat corporate earnings; (3) a 2.8% upward revision by the IMF for the Saudi economic growth in 2022 to 7.6%, due to higher oil production in line with the OPEC+ agreement and stronger-than-anticipated growth in the non-oil sector; 4) IMF forecasts that Saudi Arabia would post in 2022 its first fiscal surplus in about a decade; and 5) prospects of increased banks' profitability amid a global monetary tightening environment. Within this context, Standard and Poor's said that for every parallel shift upward in interest rates of 100 basis points, Saudi banks' net income is likely to rise by 13% and return on equity an additional 1.5%.

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The breakdown of the TASI by the industry groups during the first five months of 2022 shows that the diversified financial sector registered the highest index expansion of 28.82%, followed by the energy sector with +27.41%, the healthcare equipment and services sector with +26.05%,the utilities sector with +23.29%, the media & entertainment sector with +23.17%, the banks sector with +21.0%, the software & services sector with +13.35%, the food & beverage sector with +8.77%, the materials sector with +5.80%, the real estate management and development sector with +5.57%, the food & staples retailing sector with +3.08% and the capital goods sector with +0.15%. In contrast, the consumer durables and apparel sector reported the highest index contraction with -18.99%, followed by the pharma, biotech and & life science sector with -16.14%, the retailing sector with -15.69%, the commercial and professional services sector with -10.82%, the insurance sector with -9.67%, the REITs sector with -3.88%, the transportation sector with -3.14%, the consumer services sector with -3.0%, and the telecommunication services sector with -0.34%.

In line with strong equity price gains during the first five months of 2022, the number of listed companies increased from 210 at end-2021 to 214 at end-May 2022. Within this context, the Saudi market capitalization increased by 24.5% over the first five months of the year, moving from US$ 2,669.1 billion at end-2021 to US$ 3,323.6 billion at end-May 2022. This followed a 10.0% rise in the Saudi market capitalization in 2021.

Concomitantly, the total trading value in the Saudi Exchange contracted by 14.4% year-on-year during the first five months of 2022, reaching US$ 238.4 billion as compared to US$ 278.5 billion during the same period of 2021.

The division of the total turnover by industry groups during the first five months of 2022 showed that four out of 21 sectors captured more than half of total activity (56.9%), namely the materials sector with 24.3%, the banks sector with 23.1%, the telecommunication services sector with 5.0% and the real estate management and development sector with 4.5%. Given the contraction in total turnover and the rise in market capitalization, the annualized turnover ratio fell to 17.2% on the Saudi Exchange during the first five months of 2022 as compared to 26.0% during the same period of 2021.

As to fixed income markets, Saudi debt papers remained under downward price pressures over the first five months of 2022, mainly tracking US Treasuries move, as the 10-year benchmark yield topped the 3.0% level for the first time since November 2018 amid an aggressive US Federal Reserve monetary policy tightening aimed to tame 40-year high inflation.

BANKING SECTOR RATIOS

	2017	2018	2019	2020	2021	Apr-22
Banking sector dimension in economy						
Assets/GDP	91.0%	81.3%	88.5%	113.0%	104.9%	86.9%
Deposits/GDP	63.2%	56.7%	60.4%	73.7%	67.3%	55.9%
Loans to private sector/GDP	52.3%	47.1%	50.1%	64.6%	62.8%	53.3%
Loans to public sector/GDP	2.1%	1.8%	2.1%	3.0%	3.0%	2.5%
Growth rates (YTD)						
Assets	2.7%	2.0%	9.7%	13.2%	10.0%	3.4%
Loans to the private sector	-0.9%	2.8%	7.3%	14.3%	15.3%	5.9%
Investments	11.7%	8.4%	18.7%	12.7%	6.1%	-0.4%
Deposits	0.2%	2.5%	7.3%	8.2%	8.3%	3.7%
Capital and reserves	6.3%	-4.3%	13.0%	9.9%	11.3%	8.6%
Profit growth (year-on-year)	8.6%	9.8%	4.5%	-23.1%	-	-
Financial ratios						
Primary liquidity/Deposits	22.5%	19.7%	19.5%	20.2%	15.5%	14.4%
Liquid assets/Deposits	50.6%	49.4%	52.3%	54.4%	49.0%	46.6%
Loans to the private sector/Deposits	82.7%	83.0%	83.0%	87.7%	93.3%	95.3%
Loans to the public sector/Deposits	3.3%	3.2%	3.4%	4.1%	4.5%	4.4%
Total loans/Deposits	86.0%	86.2%	86.4%	91.7%	97.9%	99.8%
Capitalization						
Capital accounts/Assets	15.4%	14.7%	14.9%	14.0%	14.4%	14.1%
Profitability						
ROAA	1.89%	2.03%	2.00%	1.38%	1.72%	1.97%
ROAE	12.5%	13.5%	13.5%	9.6%	12.1%	13.8%

Sources: Saudi Central Bank, Bank Audi's Group Research Department

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In details, Saudi sovereigns maturing in 2026 and 2030 registered price contractions of 6.63 pts and 9.0 pts respectively during the first five months of 2022. Saudi Aramco'25 closed down by 5.89 pts. Prices of STC'29 fell by 11.55 pts. SABIC'28 posted price drops of 10.89 pts. SEC'24 traded down by 5.25 pts. This followed across-the-board price contractions in 2021, tracking US Treasuries move on prospects of a global monetary policy tightening after reopenings.

In the aim of shoring up its finances against the Coronavirus pandemic, Saudi Arabia tapped international bond markets three times in 2021 through the sale of a US$ 5 billion dual-tranche bond in February, a € 1.5 billion dual-tranche bond in March and US$ 3.25 billion Sukuk and conventional bonds in November. Within this context, it is worth noting that KSA didn't tap international bond markets this year as the Kingdom expects to post in 2022 its first fiscal surplus since 2013 amid rising oil prices and production.

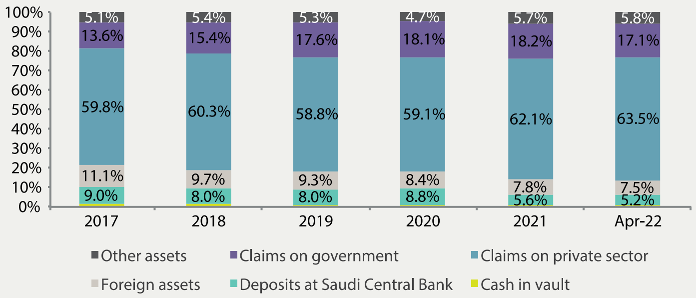
As to the cost of insuring debt, Saudi Arabia's five-year CDS spreads, which measure the market's perception of sovereign risks, expanded by 14 bps during the first five months of 2022 to reach 63 bps at end-May, staying well below the average regional sovereign five-year CDS spreads of 235 bps. This followed a 16 bps contraction in 2021.

As to credit ratings, Fitch Ratings revised in April 2022 the outlook on Saudi Arabia's long-term foreign currency Issuer Default Rating to "Positive" from "Stable" and affirmed the rating at "A". The revision of the outlook reflects, according to Fitch, improvements in the sovereign balance sheet given higher oil revenue and commitment to fiscal consolidation.

In parallel, S&P Global Ratings revised in March 2022 its outlook on Saudi Arabia to "Positive" from "Stable". At the same time, S&P affirmed its unsolicited long-term and short-term foreign and local currency sovereign credit ratings at "A-/A-2". The "Positive" outlook reflects S&P's expectation of improving GDP growth and fiscal dynamics over the medium term, tied to the country's emergence from the COVID-19 pandemic, improved oil sector prospects and the government's reform programs.

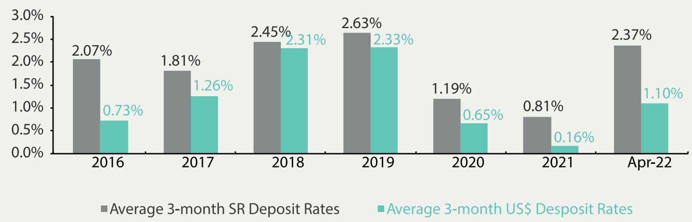
In the coming period, market players would continue to weigh persistent global growth concerns against prospects of a more aggressive monetary policy tightening by the US Federal Reserve, while Saudi equities are set to continue to benefit from multi-year oil price highs and global interest rate hikes.

BANKING SECTOR ASSET COMPOSITION



Sources: Saudi Central Bank, Bank Audi's Group Research Department

BANKING SECTOR DEPOSIT RATES



Sources: Saudi Central Bank, Bank Audi's Group Research Department

CONCLUSION

Higher global oil prices and rising production volumes, alongside a recovery from the COVID-19 pandemic, are supporting Saudi Arabia's fiscal and GDP growth dynamics, as well as its already strong external metrics. Real GDP growth will rise to 7.6% this year, and average around 3.0% over the next five years as per new IMF forecasts (within the recently released World Economic Outlook), a stronger trend than in the years running up to the pandemic.

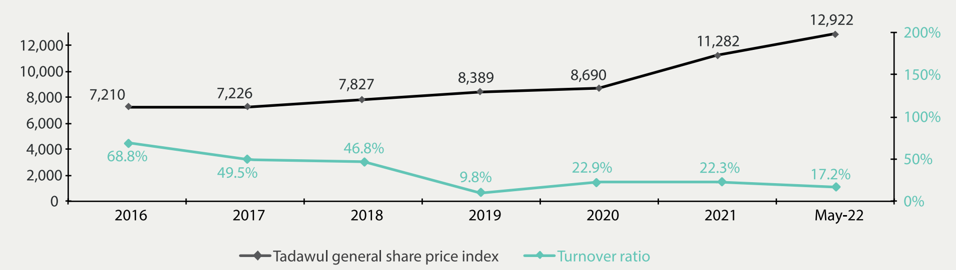
Looking forward, the structural diversification of the economy away from oil and upstream hydrocarbons Is set to continue, with the non-oil private sector accounting for over 50% of GDP, significantly higher than a decade ago. Reform efforts are increasing freedoms and jobs for women, but struggle to create sufficient jobs for the fast-growing population. The government has also pledged to make the country carbon neutral by 2060 and plans to invest heavily in renewable energy and hydrogen and other alternate fuels. Given the size of oil production and associated economies of scale, carbon emissions per barrel produced remain relatively low on a comparative basis. S&P sees Saudi Arabia as relatively resilient to longer-term energy transition risk thanks to its low carbon emissions per barrel, large reserves, low cost of production per barrel, and appetite for further capital expenditure.

SELECTED STOCK MARKET INDICATORS

	2017	2018	2019	2020	2021	May-22
Market capitalization (US$ billion)	450.6	495.7	2,406.8	2,427.1	2,669.1	3,323.6
Trading value (in US$ billion)	223.0	232.2	234.7	556.7	596.2	238.4
Number of transactions (in millions)	21.9	25.0	28.4	76.7	91.9	39.0
General share price index (base 1999=100)	7,226	7,827	8,389	8,690	11,282	12,922
Number of listed companies	179	190	199	203	210	214
Change in share price index	0.2%	8.3%	7.2%	3.6%	29.8%	14.5%
Price/Earnings ratio	15.2x	15.8x	19.5x	29.2x	20.6x	19.3x
Price/Book value ratio	1.7x	1.8x	4.3x	4.4x	4.1x	4.7x
5 year CDS spread (bps)	92	105	57	65	49	63

Sources: Saudi Exchange, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Saudi Exchange, Bank Audi's Group Research Department

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At the external level, Saudi Arabia's current account surplus is set to increase to 19% of GDP in 2022 and 16% of GDP in 2023 according to Moody's, up from 5% of GDP in 2021. Saudi Central Bank reserves are set to rebound above US$ 500 billion in 2022-2023 with large current account surpluses, even as public institutions and enterprises, notably the PIF, continue to invest abroad (as well as domestically). Saudi Arabia has one of the highest reserve coverage ratios among sovereigns at more than 20 months of current external payments.

At the fiscal level, the government fiscal position is set to return to surplus for the first time since 2013. Moody's project that surpluses will average around 6% of GDP in 2022-2023, compared to a deficit of 2% of GDP in 2021. This will be driven mainly by a significant increase in government oil revenues. spending control will broadly persist despite higher oil prices, given uncertainty over long-term oil prices; commitment by the authorities to make the budget resilient to lower oil prices in line with the fiscal sustainability programme; and higher spending by the broader public sector to support economic growth and job creation. Fitch now forecast that government debt/GDP will remain below 30% until 2025. The government will also retain significant fiscal buffers, including deposits at the central bank in excess of 10% of GDP.

The analysis of the Kingdom's short to medium term outlook actually requires a careful examination of strengths and opportunities relative to the threats and challenges. At the level of the former, we mention the moderate government and broader public sector debt burden, the robust fiscal and foreign-currency reserve buffers and prudent banking regulation and the high per-capita income, in addition to large stock of proved oil reserves and low extraction costs.

At the level of risks constraining the outlook, we mention the high economic and fiscal vulnerability to declines in oil demand and prices, the rigid government spending structure and pressures due to high unemployment and rapid population growth and the political risks stemming from regional geopolitical tensions. While risks and challenges are real, we believe strengths and opportunities far outpace threats at the foreseeable horizon.

Finally, in its last Article IV Consultation Mission Report, the IMF highlighted that Saudi Arabia entered the COVID-19 pandemic with strong policy buffers and a positive reform momentum and commended the authorities for their quick and decisive policy response, which helped cushion the pandemic's impact. Noting the economic rebound in the non-oil sector, they stressed that the remaining pandemic-related policy support should be carefully withdrawn to continue supporting the ongoing recovery, while the Vision 2030 reform agenda should continue to be implemented to promote strong, sustained, diversified, inclusive, and greener growth.

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