FINANCIAL STABILITY REPORT

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البنك المركزي السعودي

SAMA

Saudi Central Bank

Financial Stability Report 2024

Saudi Central Bank

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The global financial system proved resilient following the banking turmoil that occurred during 2023, and despite increased global interest rates on the back of central bank efforts to curb inflationary pressures and maintain price stability. The resilience staged by the global financial system is a testament to the effectiveness of the post global financial crisis reform agenda.

Despite global economic challenges and a domestic contraction in oil activities of 9% year-over-year, non-oil GDP expanded by 4.4% year-over-year in the Kingdom of Saudi Arabia, highlighting the increasing role of the non-oil sector as a key driver of domestic growth. Non-oil activities significantly improved its contribution to total GDP, rising to 49.9%, driven by the Kingdom's continued efforts to diversify the economy through projects associated with Saudi Vision 2030.

The financial system has been instrumental in supporting this economic performance, as it remains highly resilient, reflecting the progress made by regulators and financial institutions in improving financial buffers and practices. Operating under SAMA's supervision, banks, finance companies, and payment providers expanded financial services to all segments of the private sector and individuals to contribute in a well-functioning financial system.

Consistent with our mandate to maintain monetary stability, support the stability of the financial sector and promote trust therein, and support economic growth, SAMA has long placed great importance on banking system resilience. This has resulted in prudential ratios well above SAMA's requirements, reflecting a liquid and well-capitalized banking system. Banks have also maintained adequate lending capacity to support the Kingdom's economic reforms and meet growing domestic demand. This will complement the efforts underway to further enhance and deepen our domestic capital markets to meet the funding needs of the economy.

Development of advanced financial system infrastructure has been one of the principal areas supported and monitored by SAMA. This has been evident in the sophisticated Saudi payment sector, and its continuous development to serve the needs of individuals and corporations alike.

The Saudi Vision 2030 programs and initiatives, along with the resilience of the financial system, will support the continued growth of the Saudi economy in 2024. In an uncertain global macroeconomic environment, however, risks could spread quickly. SAMA, therefore, continues to monitor global and domestic economic developments, to inform any policy intervention should it be required to ensure the smooth functioning of the financial system, in-line with SAMA's mandate.

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Abbreviations

AEs	Advanced Economies
APR	Annual Percentage Rate
ATV	Average Transaction Value
BNPL	Buy Now Pay Later
BoE	Bank of England
CAR	Capital Adequacy Ratio
CBOE	Chicago Board Options Exchange
CCE	Circular Carbon Economy
CCyB	Countercyclical Capital Buffer
CMA	Capital Market Authority
CMIs	Capital Market Institutions
CPI	Consumer Price Index
CRC	Cyber Risk Control
DBR	Debt Burden Ratio
DPMs	Discretionary Portfolio Management Services
D-SIBs	Capital Surcharges for Domestic Systemically Important Banks
DSTI	Debt Service to Income Ratio
EBPP	Electronic Bill Presentment and Payment
ECB	European Central Bank
EMEs	Emerging Market Economies
EMI	Electronic Money Intuitions
Fed	US Federal Reserve Bank
Fintech	Financial Technology
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSDP	Financial Sector Development Program
FSR	Financial Stability Report
FX	Foreign Exchange
GASTAT	General Authority for Statistics
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GWP	Gross Written Premium
HQLA	High-Quality Liquid Assets
IA	Insurance Authority
IBNR	Incurred But Not Reported
IIF	Institute of International Finance
IMF	International Monetary Fund
IPS	Instant Payments System
Kafalah	Small and Medium Enterprises Loan Guarantee Program

LCR	Liquidity Coverage Ratio
LDR	Loan to Deposit Ratio
LTV	Loan to Value
M3	Broad Monetary Aggregate
MBS	Mortgage-Backed Securities
MMBtu	Metric Million British Thermal Unit
MOF	Ministry of Finance
MOMRA	Ministry of Municipal and Rural Affairs and Housing
MOVE	Merrill Option Volatility Estimate
MSMEs	Micro, Small, and Medium Enterprises
NCI	Net Claims Incurred
NDA	Net Domestic Assets
NDMC	National Debt Management Center
NEP	Net Earned Premium
NFC	Near Field Communication
NFSC	National Financial Stability Committee
NGFS	Network for Greening the Financial System
NPLs	Non-Performing Loans
NSFR	Net Stable Funding Ratio
OPEC	Organization of the Petroleum Exporting Countries
P/E	Price to Earning
PIF	Public Investment Fund
PIs	Payment Institutions
PMI	Purchasing Managers Index
POS	Point of Sales
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement
RWAs	Risk-Weighted Assets
SAIBOR	Saudi Arabian Interbank Offered Rate
SAMA	Saudi Central Bank
SAR	Saudi Riyal
SIMAH	Saudi Credit Bureau
SLR	Supplementary Leverage Ratio
SRC	Saudi Real Estate Refinance Company
VIX	Volatility Index
WEO	World Economic Outlook

Executive Summary

During 2023, a variety of challenges stemming from the pandemic were alleviated and the global economy proved more resilient than expected. On a global level, inflation fell from its extreme levels as supply chain pressures eased. However, in an environment of heightened macroeconomic uncertainty, risks to the outlook remain elevated. The high interest rate environment, combined with geopolitical tensions and potential risks associated with debt sustainability, may impact the global macrofinancial environment. This is particularly visible in the growing debt burden around the world, which has become a critical issue for non-financial sectors, particularly in countries with limited fiscal space.

In the midst of global uncertainty, Saudi Arabia's domestic economy proved resilient. The domestic economy contracted slightly in 2023 due to a decline in oil activities. However, the Kingdom continued to make steady strides in its domestic development agenda, with Vision 2030 initiatives serving as the primary catalyst. This was reflected in the non-oil activities and their contribution to the economy. Additionally, unemployment among Saudis dropped to its lowest historic level in 2023, reflecting the relevance of the non-oil sector in the economy.

Inflation decelerated in 2023 due to moderation in food and transport prices. Although SAMA raised the policy rate four times in 2023, broad money supply recorded robust growth. The fiscal balance shifted back to deficit in 2023 due to lower oil revenues and increased spending. On the other hand, the current account recorded a surplus in spite of lower oil exports.

The Saudi banking sector assets and credit continued to grow in 2023, driven primarily by corporate credit, which outpaced the growth in household credit. Banks have adequate lending capacity to support the Kingdom's economic reforms. Lending to the private sector, including micro, small and medium enterprises is expected to expand further with favorable growth prospects in the non-oil activities, supported by the government's initiatives. The banking sector also continued to maintain high asset quality with a low level of non-performing loans and a sufficiently high level of provisioning coverage. Banks continued to maintain sound credit underwriting standards and to adhere to SAMA's requirements for responsible lending, credit risk management and loan to value. Liquidity remained adequate with continued growth in the deposit base with a notable shift to time and savings deposits, which further reinforced the stickiness of deposits, and supported with other sources of long-term funding.

The banking sector ended the year with a solid prudential liquidity position, with the liquidity coverage ratio and the net stable funding ratio above SAMA's regulatory minimum requirements. The sector remained well capitalized, with the capital adequacy ratio increasing as growth in equity exceeded the growth rate of risk-weighted assets, driven by factors such as improved profitability and greater capital issuances throughout the year.

The finance companies sector experienced substantial expansion in total assets in 2023, primarily driven by growth in credit portfolios, particularly in retail lending and non-real estate financing. Despite the increase in credit activities, the leverage ratio remained within regulatory limits, suggesting that finance companies have ample capacity for further credit extension. Additionally, finance companies have been increasingly diversifying their funding through various funding products offered by Saudi Real Estate Refinance Company, which has enabled greater flexibility in liquidity management for the sector. In spite of higher interest expenses in 2023, the sector continued to post profits, albeit at a lower rate.

The insurance sector recorded premiums growth in 2023, in line with the increase in non-oil sector. The loss ratio decreased, boosting profitability; while an increase in reserves (notably through a significant increase in unearned premium reserves) and improved solvency margins provided ample buffers against risks. Profitability soared with a significant rise in net income and investment returns. Although premiums written through intermediaries increased, their share of the gross written premiums growth rate has slightly declined, signaling a nuanced shift in health and motor insurance underwriting dynamics.

Capital market institutions exhibited strong performance during the year. Despite higher operating expenses related to employees, capital market institutions' net income continued to increase. Margin lending increased while margin utilization rates remained stable. Furthermore, the market experienced notable growth in the Fintech sector, leading to a substantial increase in discretionary portfolios for retail investors. Profitability and liquidity of capital market institutions improved during 2023, supporting the sector's capitalization and the required coverage to meet short-term liquidity needs.

Saudi Arabia's payment sector continued to play a pivotal role in the financial system. The development of advanced financial market infrastructure and improvement in payment companies business models have also helped increased financial inclusion. On the other hand, the increased use of technology and automation in the financial sector has also elevated the risk of cyber incidents and fraud. To counter and mitigate such threats, SAMA has undertaken several initiatives such as cyber-threat-led assessment for shared services and sectoral cyber-risk profiling to monitor relevant emerging financial and operational risks to proactively address such concerns.

1

Global Economy

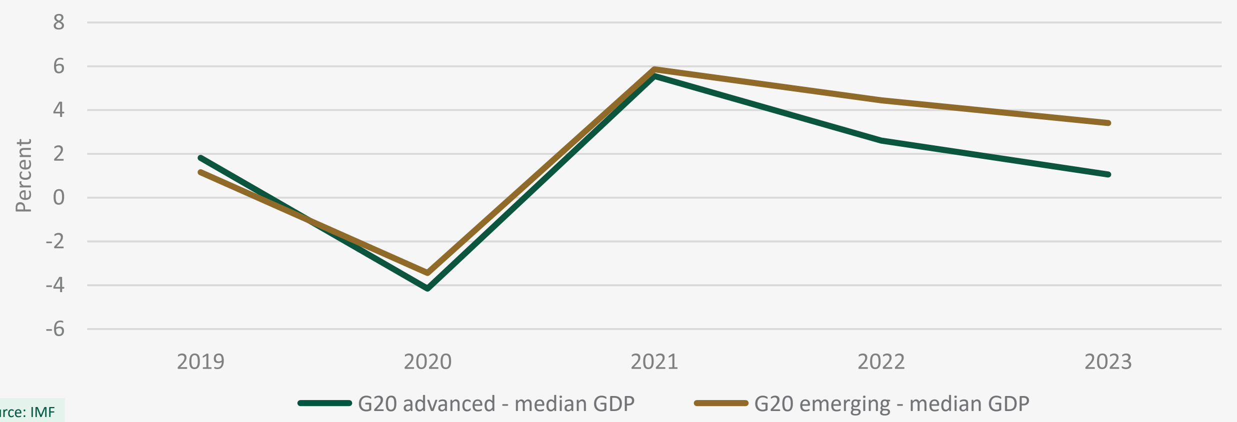
1.Global Economy

Despite the downward path of inflation in 2023, risks to the global financial system remained prominent. This was due to the high interest rate environment combined with geopolitical tensions and potential risks associated with debt sustainability.

The shift toward a high interest rate environment, amongst other factors, had a noticeable impact on the global economy. In G20 advanced economies (AEs), real GDP growth rates recorded a steady deceleration during 2023, falling to 1.1%. The same trend was observed in G20 emerging market economies (EMEs), as the growth rate decreased to 3.4% at the end 2023, although that rate is higher than pre-COVID-19 levels (Chart 1.1). Global growth is expected to reach 3.2%, based on the latest International Monetary Fund (IMF) projections in its July 2024 World Economic Outlook (WEO).

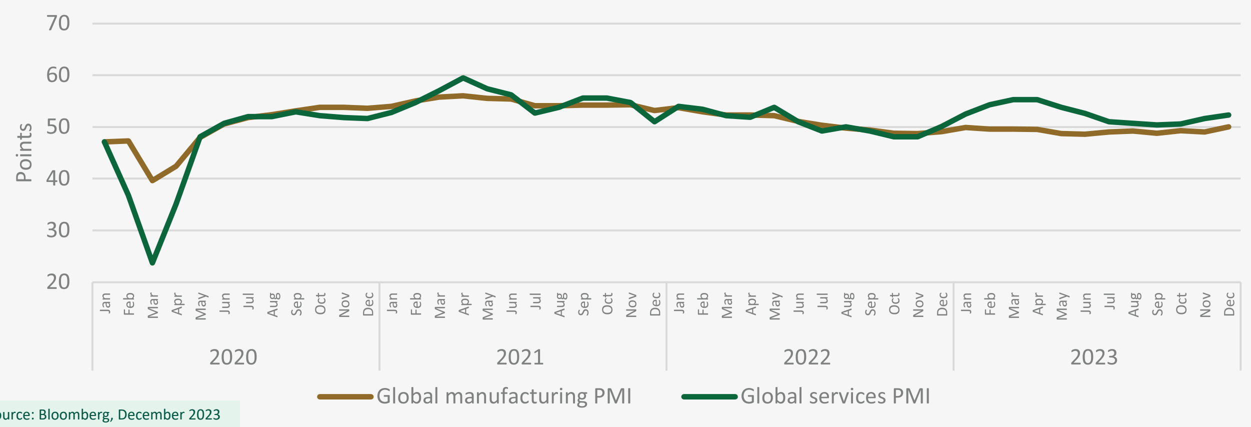
The global purchasing managers' indices (PMI) reflected some positive developments during 2023. The global services sector PMI rose significantly in 2023, reaching its highest level of 55 points in April. The manufacturing PMI stabilized during 2023, with a slight pick-up by the end of the year (Chart 1.2).

Chart 1.1: Annual GDP Growth Rates in Real Terms



Source: IMF

Chart 1.2: PMI

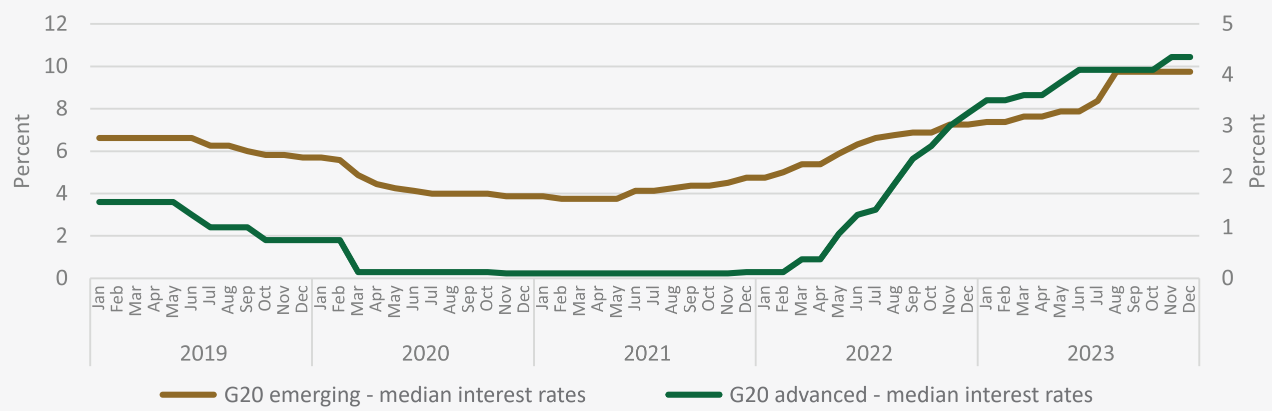


Source: Bloomberg, December 2023

Central banks continued their tightening stance to mitigate the impact of recent inflationary episodes.

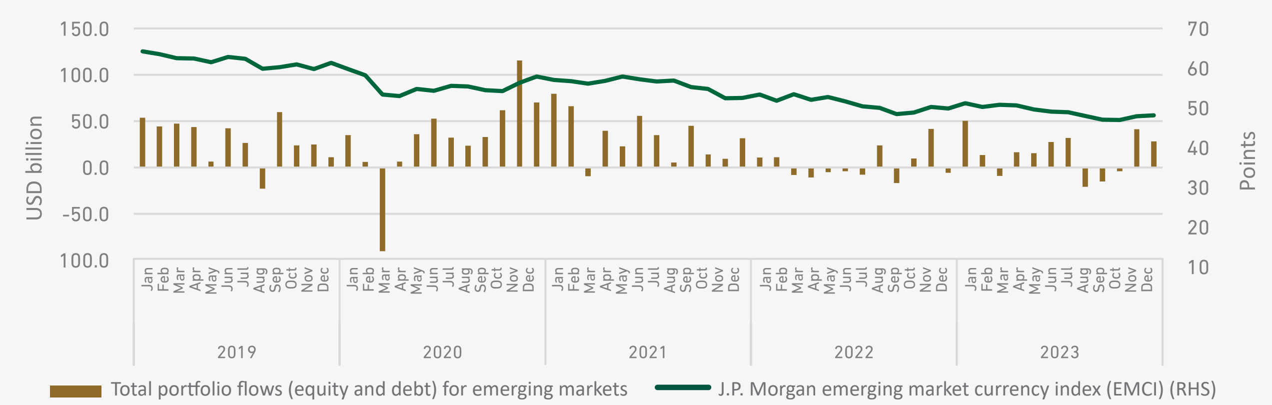
Since early 2022, interest rates accelerated sharply upwards (Chart 1.3). Higher rates in AEs resulted in EMEs facing currency depreciation and some capital outflows, though the impact was somewhat offset by the interest rate hikes by EMEs (Chart 1.4).

Chart 1.3: Policy Rates



Source: Bloomberg, December 2023

Chart 1.4: Total Portfolio Flows for Emerging Markets

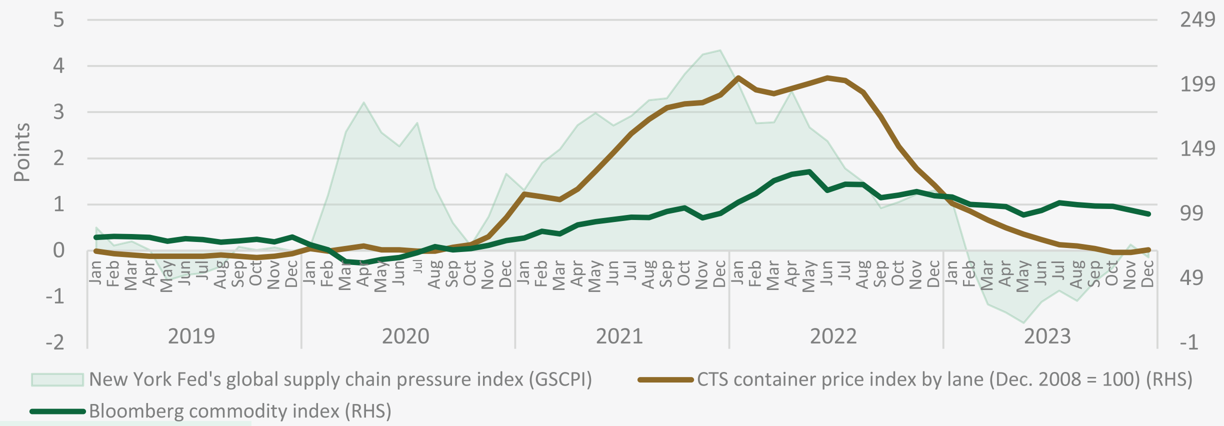


Source: Bloomberg and IIF

Supply chains normalized over 2023, although economic uncertainty arising from geopolitical tensions and slowing economic activity presented a challenge to global supply chains.

After the prolonged impacts of the Covid-19 pandemic and the Russia–Ukraine conflict, supply chain strains eased significantly in 2023 compared to 2022, as bottlenecks abated and industrial output increased (Chart 1.5). However, risks remain tilted to the downside as geopolitical events coupled with economic uncertainty may pressure supply chains going forward.

Chart 1.5: Global Supply Chain

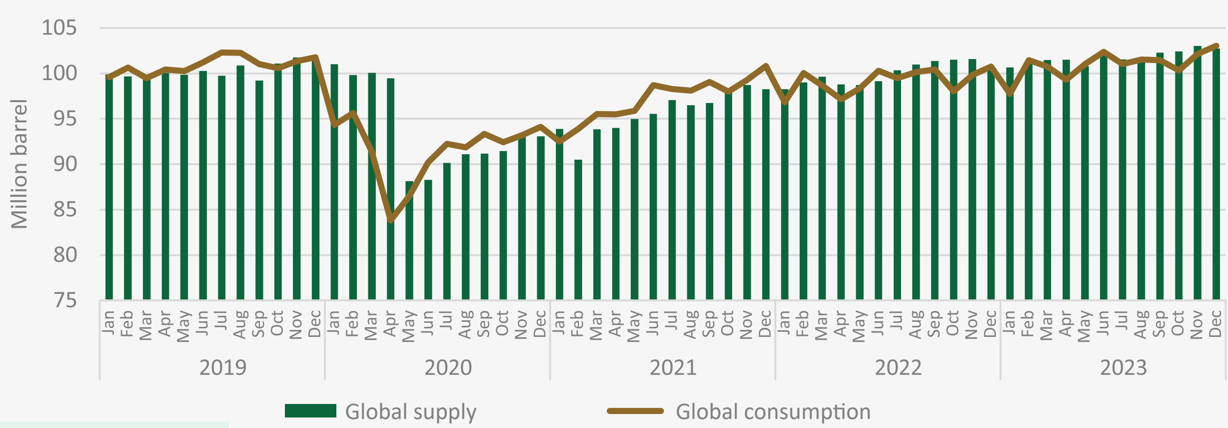


Source: Bloomberg, December 2023

Although the easing of supply chains led to improvements in energy markets in 2023, several vulnerabilities kept energy markets volatile to some extent.

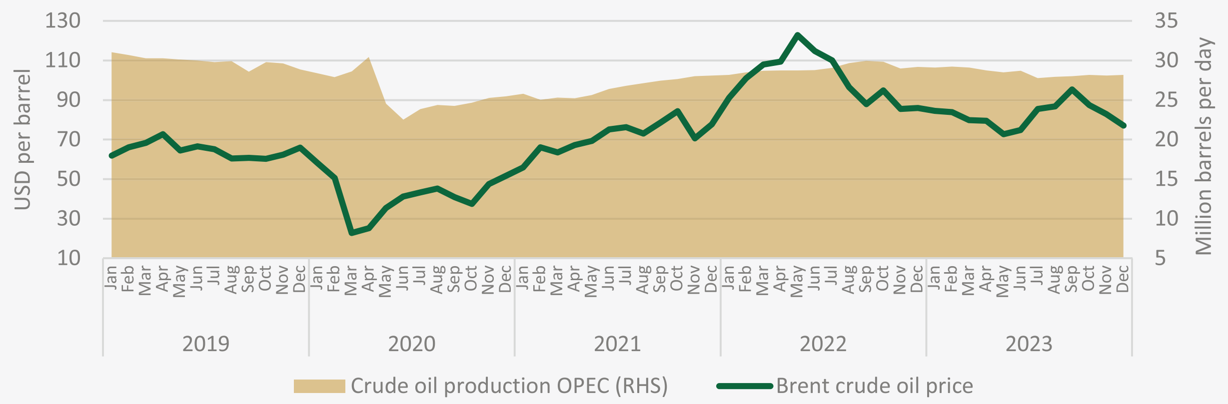
Amid concerns about the effect of slowing global growth, oil market fundamentals were somewhat volatile, with oil prices averaging $82.5/b throughout 2023 (Chart 1.6). In the first three months of 2023, Brent prices averaged $83/b amid concerns that banking sector turmoil might present broader challenges to the global economy. That, in turn, led the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC's decision to cut production in April as a precautionary measure to guarantee market stability amid fears of a global downturn that would curtail energy demand. Continued speculation related to recession risks alongside persistent demand concerns following a significant slowdown in Chinese factory activity led to further declines in oil prices, which bottomed out at $72/b in May. As those concerns temporarily abated, a sharp reversal was observed in the third quarter. The price of Brent crude reached its highest level of $95/b in September, only to fall to $77/b by the end of year (Chart 1.7).

Chart 1.6: Oil Market Fundamentals



Source: Bloomberg, December 2023

Chart 1.7: Oil Market Developments

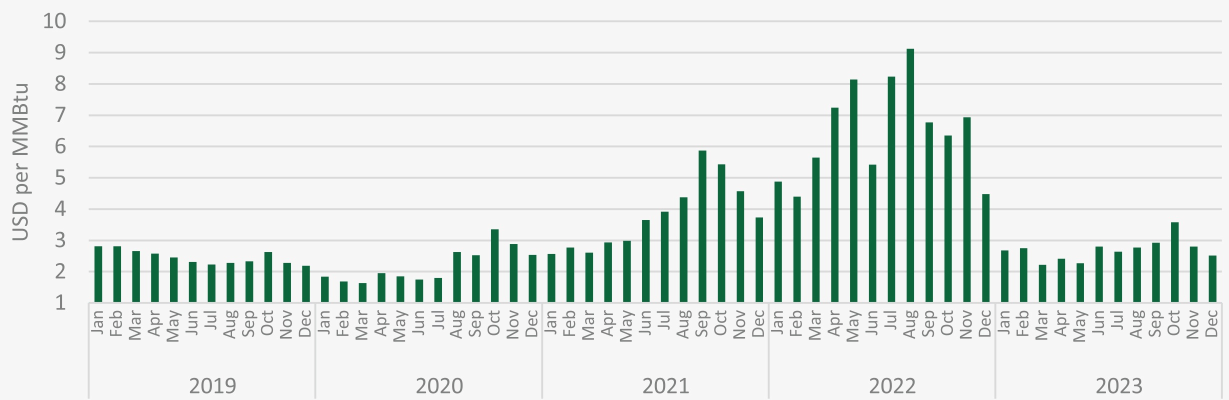


Source: Bloomberg, December 2023

Prices in the natural gas market saw a more stable year, although the market remained highly sensitive to shocks and external events.

Gas prices continued to drop since mid-December 2022 due to the robust supplies of liquefied natural gas from several global producers coupled with weather conditions that persistently limited heating demand. As a result, prices averaged $3/MMBtu with limited fluctuation over 2023 (Chart 1.8).

Chart 1.8: Natural Gas Prices

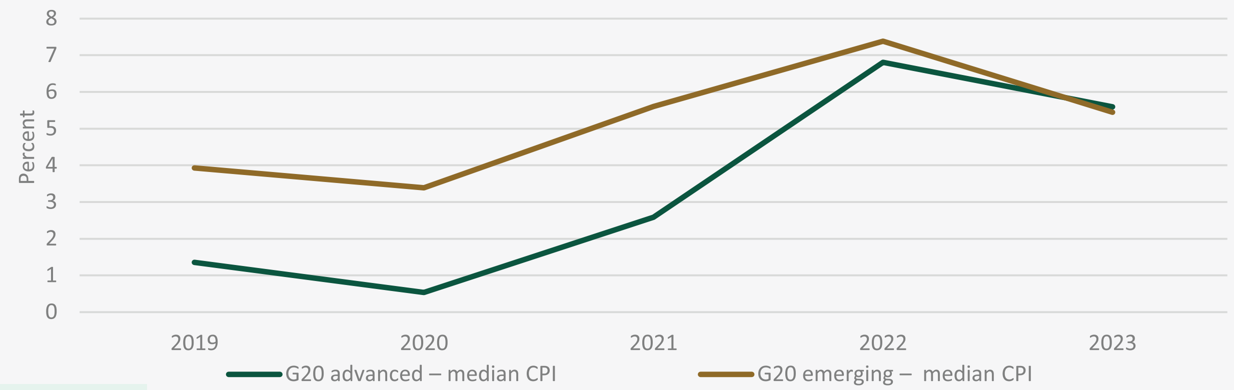


Source: Bloomberg, December 2023

The easing of supply chain issues, lower energy prices, and rising policy rates contributed to the continued deceleration of inflation rates.

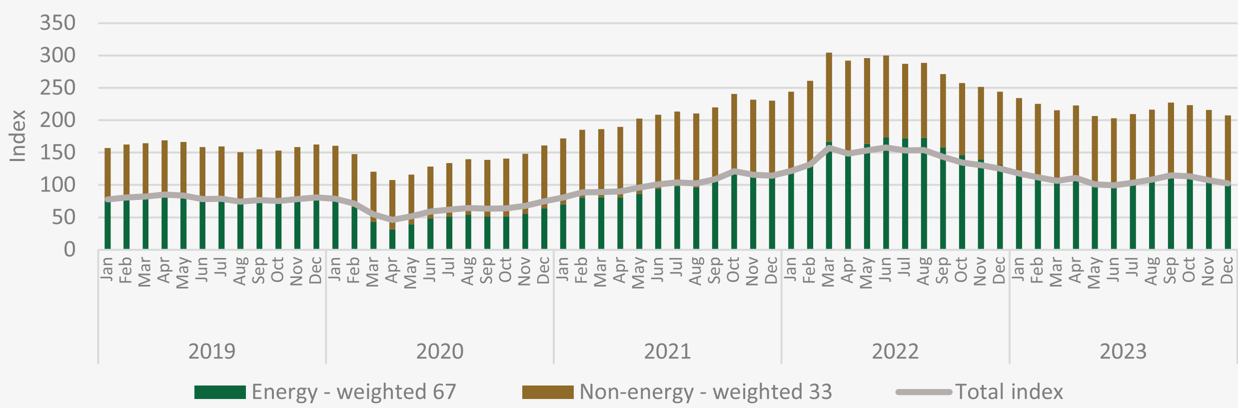
During 2023, inflation rates maintained their downward trend in both AEs and EMEs, reaching 5.6% and 5.4%, respectively. This can be attributed to multiple factors, including monetary policy tightening, lower energy and food prices, and supply chain improvement (Chart 1.9). Although commodity prices trended lower through 2023 (Chart 1.10), sustained geopolitical tensions could impact commodity prices, risking a further increase in inflation rates.

Chart 1.9: Annual Change in the Consumer Price Index (CPI)



Source: IMF, April 2024

Chart 1.10: Commodity Price Index

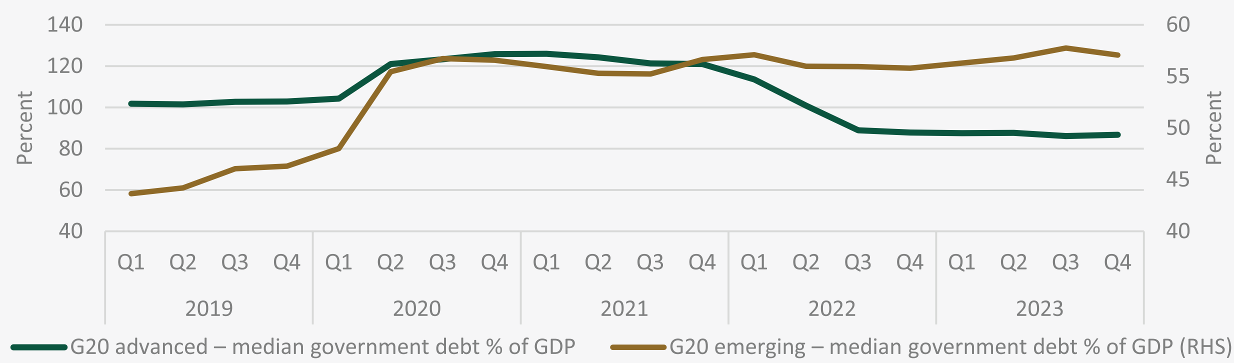


Source: World Bank, December 2023

Rising debt levels and financing costs significantly increased concerns around debt sustainability, particularly for countries with limited fiscal space.

Public debt levels were broadly elevated above pre-pandemic levels. In EMEs, debt-to-GDP rose in Q4 2023 registering a year-over-year increase of 2%. AEs, on the other hand, saw less pressure as debt-to-GDP registered a year-over-year decrease of about 23% in Q1 2023 and continued to drop over the year. One of the major ongoing risks associated with limited fiscal space remains the ability to withstand and address future shocks (Chart 1.11).

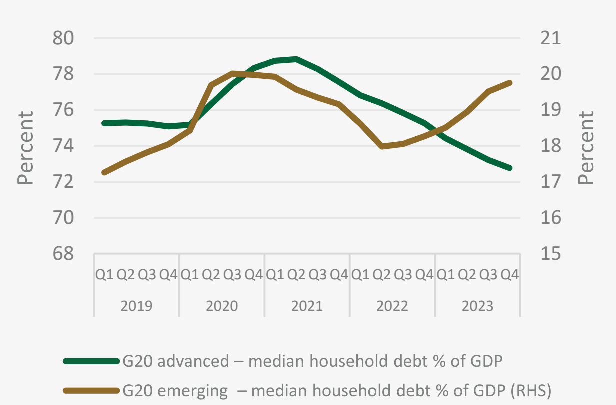
Chart 1.11: Government Debt to GDP



Source: IIF, Q4 2023

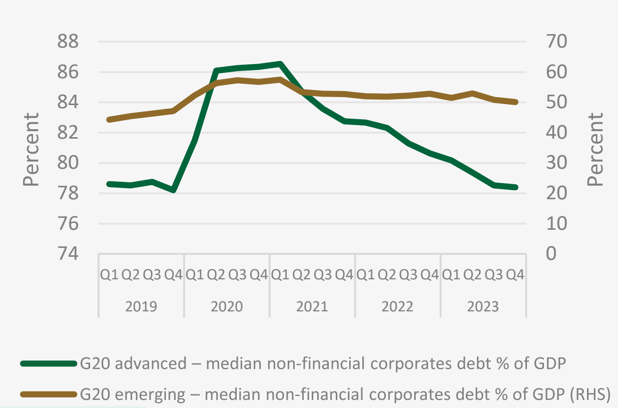
Although overall debt levels for both households and corporations remained below their 2020 peak, household debt-to-GDP in EMEs increased relatively steadily since 2022 (Chart 1.12). Corporate debt-to-GDP ratios almost fully reverted to pre-pandemic levels, which reflects nominal GDP growth rather than a significant decline in debt levels (Chart 1.13). Nonetheless, higher financing costs could increase debt burdens and add pressure on debt servicing capacity of both sectors. In a scenario of prolonged higher interest rates, managing debt-related vulnerabilities could weigh on growth in non-financial sectors.

Chart 1.12: Household Debt-to-GDP



Source: IIF, Q4 2023

Chart 1.13: Non-Financial Corporations Debt-to-GDP



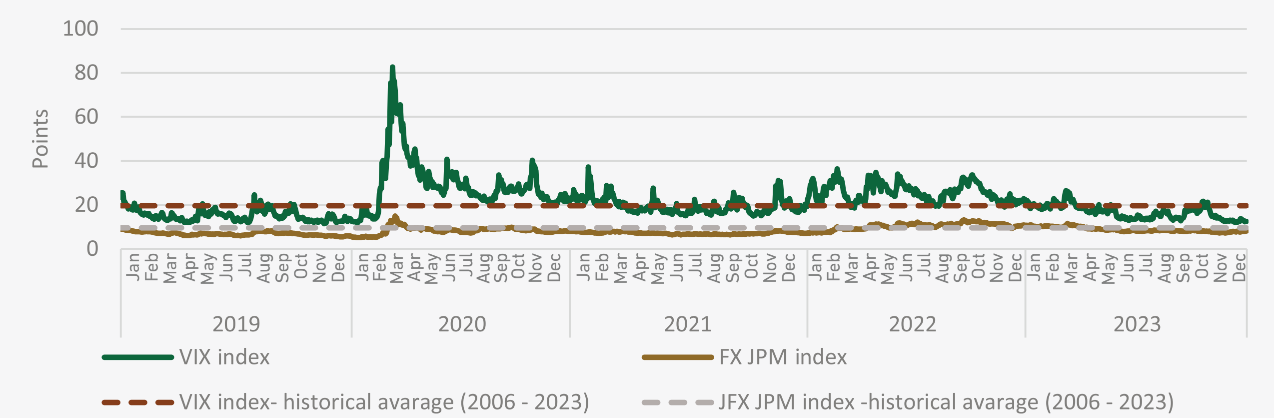
Source: IIF, Q4 2023

During 2023, equity markets experienced a noticeable improvement, while bond markets remained volatile.

Volatility across equity and foreign exchange markets eased in 2023, influenced by growing expectations in the latter half of the year that the US economy would avoid a recession and the US Federal Reserve Bank (Fed) would begin to cut interest rates. The active regulatory and supervisory responses to the 2023 banking turmoil also contributed positively to equity market performance. That led both the US equity volatility index (VIX) and the foreign exchange (FX) volatility index to fall below historical levels[1] (Chart 1.14).

There was also some slight divergence between AEs and EMEs in relation to asset valuations. In AEs, equity valuations rebounded somewhat at the end of 2023 to approach their long-term average, driven by positive market sentiment. Meanwhile, EME equities saw minor volatility in valuations (Chart 1.15).

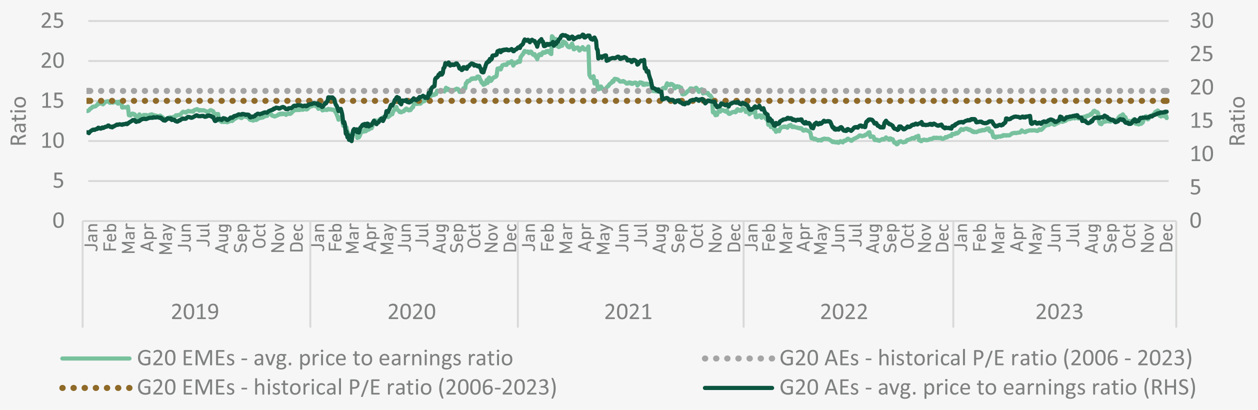
Chart 1.14: Market Volatility



Source: Bloomberg, December 2023

[1] The Chicago Board Options Exchange (CBOE) VIX reflects near-term equity market volatility derived from the S&P index. The FX reflects volatility in the exchange rate.

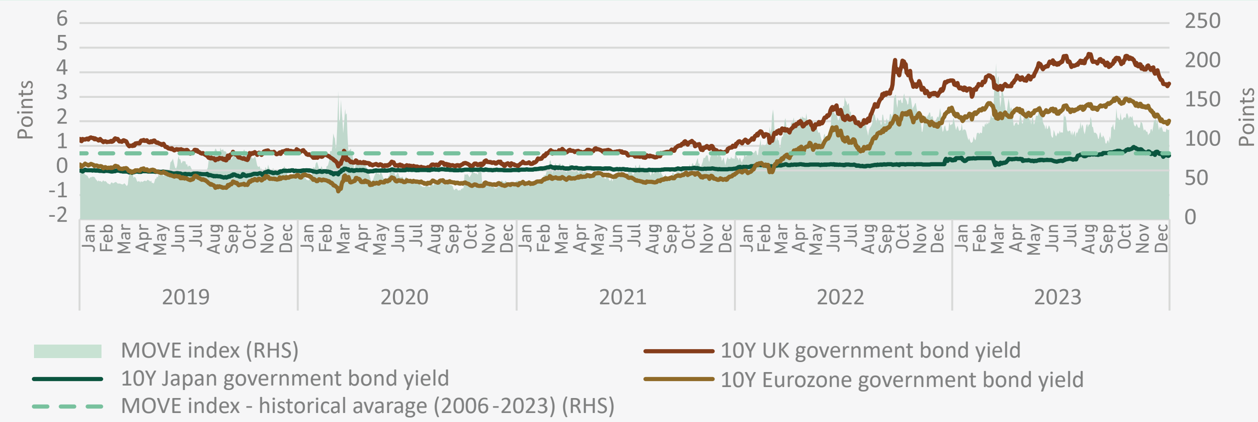
Chart 1.15: Asset Valuation



Source: Bloomberg, December 2023

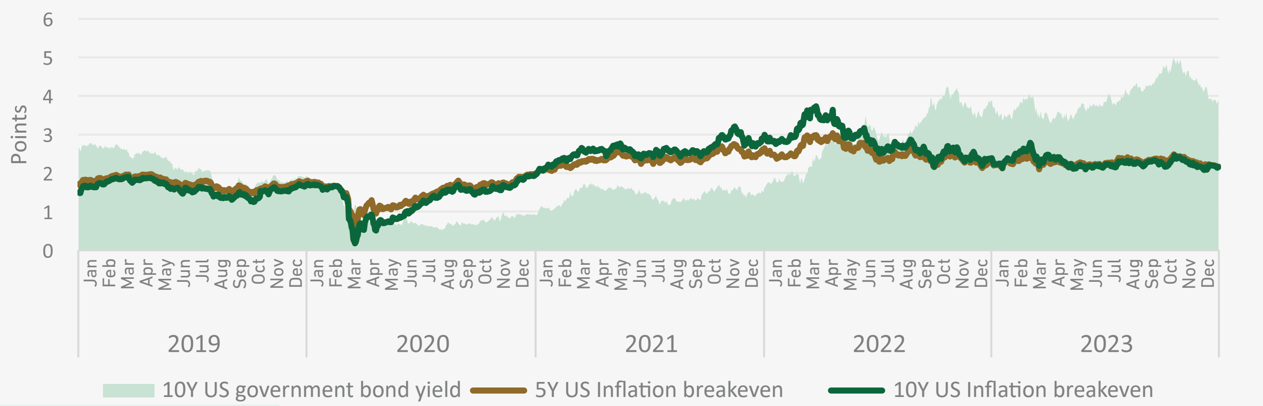
Bond market volatility increased sharply in 2023 due to the rapid interest rate hiking cycle, increased government bond issuances, as well as greater uncertainty in investor expectations for the future path of interest rates. This effect was particularly significant in government bond yields, where yields of sovereign bonds rose significantly — peaking in October as a result of the increase in term permia and government debt supply — in response to growing expectations of lower interest rates and easing inflationary pressures (Chart 1.16) and (Chart 1.17). The Merrill Lynch Option Volatility Estimate (MOVE) index, which reflects near-term bond market sentiment, was higher than historical averages since 2006.

Chart 1.16: Selected Government Bond Yields



Source: Bloomberg, December 2023

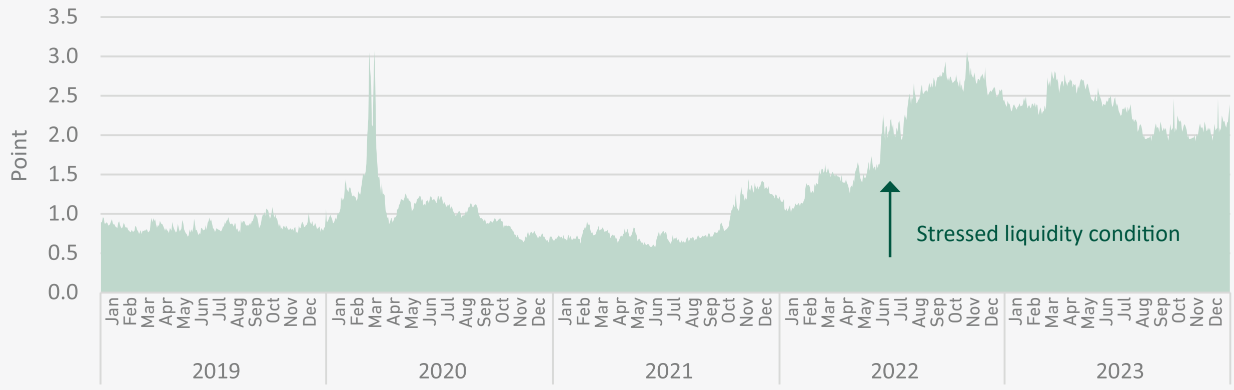
Chart 1.17: 10-Year US Government Bond Yields and Inflation Expectations



Source: Bloomberg, December 2023

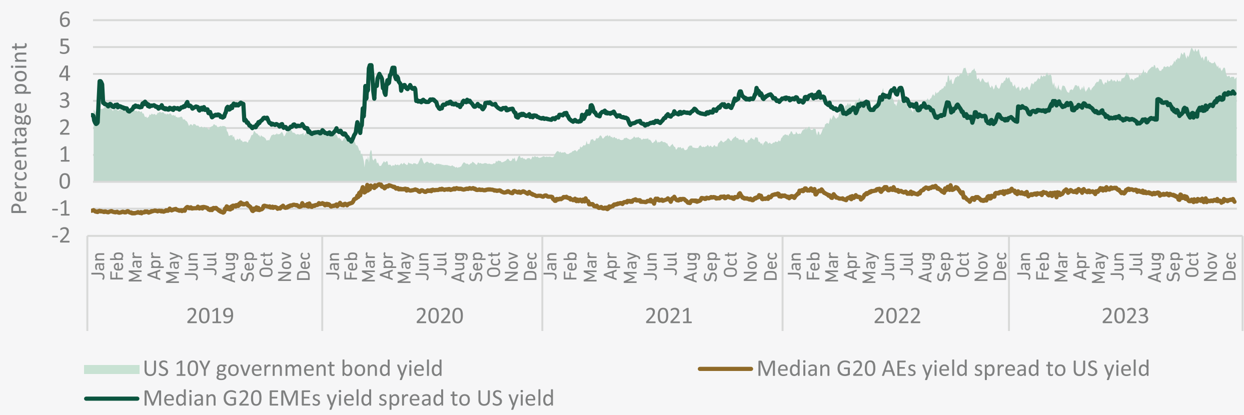
Liquidity shrunk in the US Treasury market, reflecting the impact of a range of factors, including less absorption of US Treasuries by the Fed (Chart 1.18), and broker-dealer capacity. Throughout most of 2023, improved risk sentiment led to higher demand for EME bonds. However, EME bond spreads began to widen at the end of 2023 due to changes in interest rate expectations and perceptions of higher risk (Chart 1.19).

Chart 1.18: US Government Securities Liquidity Index



Source: Bloomberg, December 2023

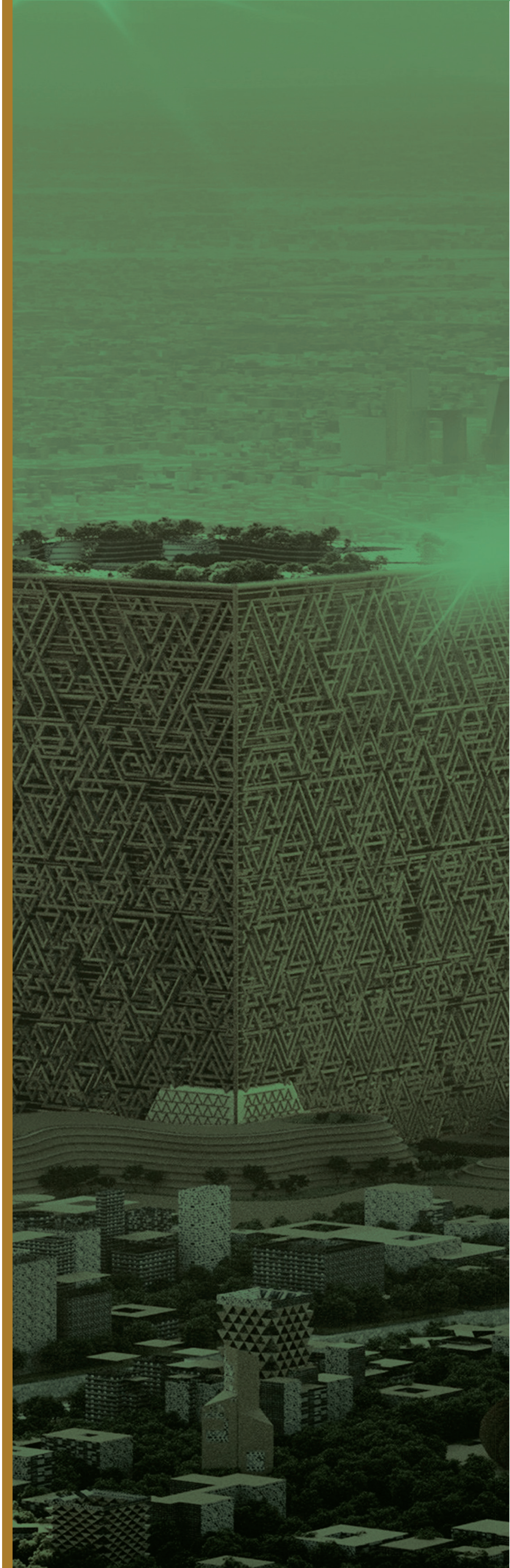
Chart 1.19: Yield Spreads to the 10-Year US Bond Yield



Source: Bloomberg, December 2023

2

Domestic Economy

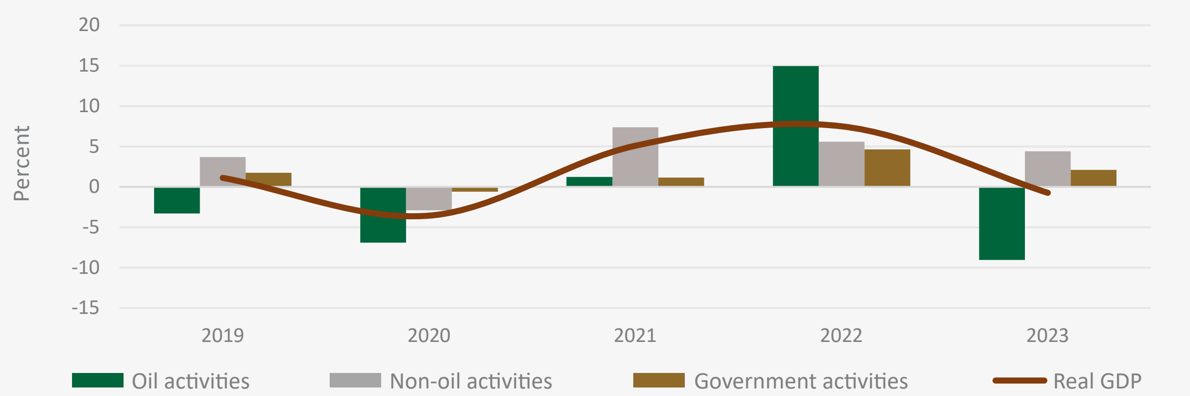


2.Domestic Economy

Saudi Arabia is transforming its economy through reforms that aim to reduce the country's reliance on oil and broaden its sources of income. The halfway point of the Kingdom's ambitious Vision 2030 blueprint, marked significant progress and reflected Saudi Arabia's commitment to achieving macroeconomic targets. Lower reliance on oil revenues and greater economic diversification mitigate potential shocks in the domestic economy.

Saudi Arabia's economy contracted by 0.8% in 2023 compared to an increase of 7.5% in 2022. This decline was attributed mainly to a reduction in oil activities, resulting from the Kingdom's decision to decrease crude output in line with OPEC and non-OPEC agreement, to support energy market stability. Oil activities declined by 9% in 2023 compared to a 15% increase in the previous year. This decline was partially offset by strong growth in non-oil activities as they grew by 4.4% and their share of overall GDP rose to 49.9%, an all-time high. This was due to the Kingdom's continued efforts to diversify its economy through Vision 2030 programs, which have resulted in noticeably greater domestic demand (Chart 2.1).

Chart 2.1: Real GDP by Main Economic Activities
(Chain-linked, 2018=100, Annual Growth)

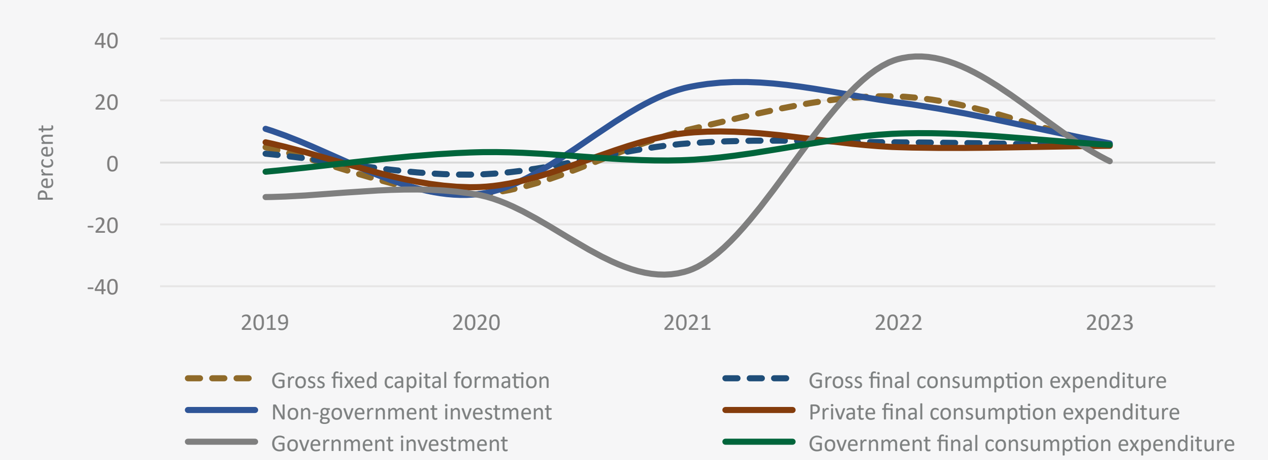


Source: GASTAT

Private consumption continued to support overall growth at a faster pace in 2023.

Private consumption expenditure registered sustained growth since the first quarter of 2021. In 2023, gross final consumption increased by 5.5%, mainly supported by private consumption, which grew by 5.3% compared to the previous year. Gross fixed capital formation recorded growth of 5.3% in 2023. This growth was supported by non-government investments, which rose by 6.2% to reach its highest level at SAR 750 billion, reflecting improvement in the performance of the private sector (Chart 2.2).

Chart 2.2: GDP by Expenditure Components
(Chain-linked, 2018=100, Annual Growth)



Source: GASTAT

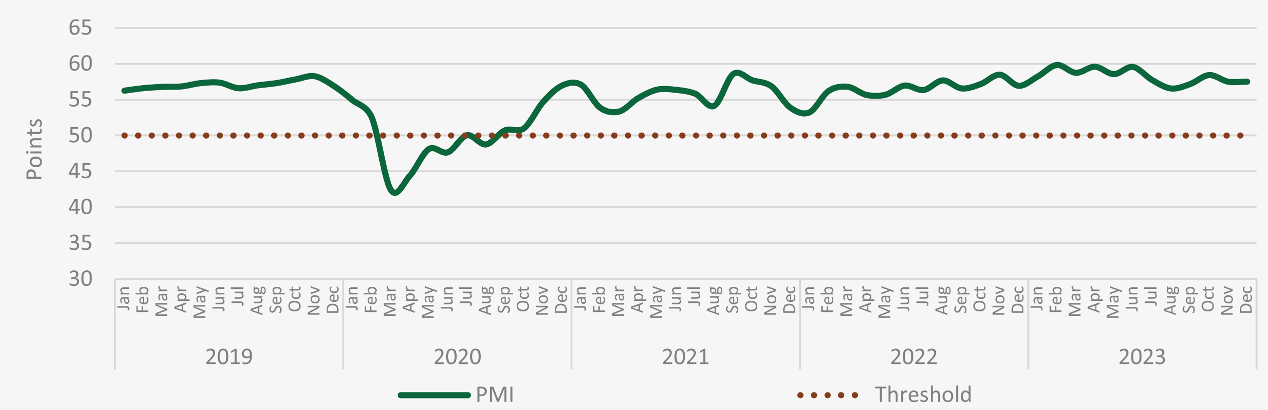
The Saudi economy is expected to grow in 2024 supported by Vision 2030 programs and initiatives.

Saudi Arabia's economy is poised for robust growth in 2024, driven by the non-oil sector and boosted by the Vision 2030 projects, some of which are set to reach critical completion milestones in 2024. Non-oil economic growth will be stimulated by domestic consumption demand and non-oil private investments given the improvements in the labor market and increased female participation in the workforce, as well as the projected positive impact of the entertainment and tourism sectors. The IMF forecasts indicate that the Kingdom's economy will grow by 1.7% in 2024[2] and that non-oil GDP will account for 71% of GDP by 2028.[3]

The PMI continued to improve in 2023, reflecting a notable improvement in private-sector performance.

As a testament to the positive momentum in the non-oil growth over the past three years, the PMI[4] also remained well above the neutral threshold (50), indicating a strong and resilient non-oil private sector (Chart 2.3). The headline index averaged 58.3 points in 2023 compared to an average of 56.5 points in 2022, reflecting continued improvement in aggregate demand.

Chart 2.3: PMI
>50 = Improvement since Previous Month



Source: Riyad Bank

[2] World Economic Outlook, July 2024.
[3] Article IV (September 2023).
[4] Riyad Bank Saudi Arabia PMI.

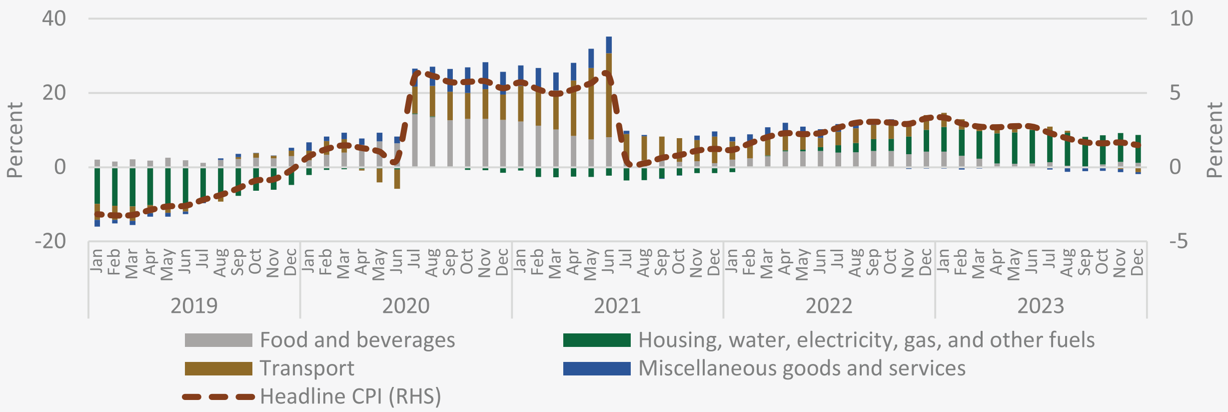
The unemployment rate among Saudis dropped to its lowest level in the fourth quarter of 2023.

The labor market reflected robust growth in the non-oil sector as overall unemployment dropped to 3.4% in Q4 2023, reflecting a decline of 0.6 percentage points from the same period in 2022. Additionally, the Saudi unemployment rate fell to an all-time low of 7.8% in Q4 2023 from 8.2% in Q4 2022. Saudi female participation in the workforce reached 35% in Q4 2023, exceeding the Vision 2030 target of 30% and showcasing the impact of programs such as the Human Capability Development Program. Unemployment rates are expected to decrease further with continued growth in non-oil activities.

Despite inflationary pressure in housing rental prices during the year, headline inflation decelerated in 2023, supported by moderation in transport and food prices.

The headline inflation rate of Saudi Arabia declined to 2.3% in 2023 from a rate of 2.5% in the previous year. The decline was driven by the global moderation in food prices, as observed also in domestic price levels for this component. Higher prices for rent (sub-component of housing, water, electricity, and gas and other fuels), was the main driver of 2023 inflation (Chart 2.4). The inflation rate in Saudi Arabia is expected to remain stable in 2024 as global supply chain pressures continue to ease.

Chart 2.4: Annual Growth of CPI (2018=100)



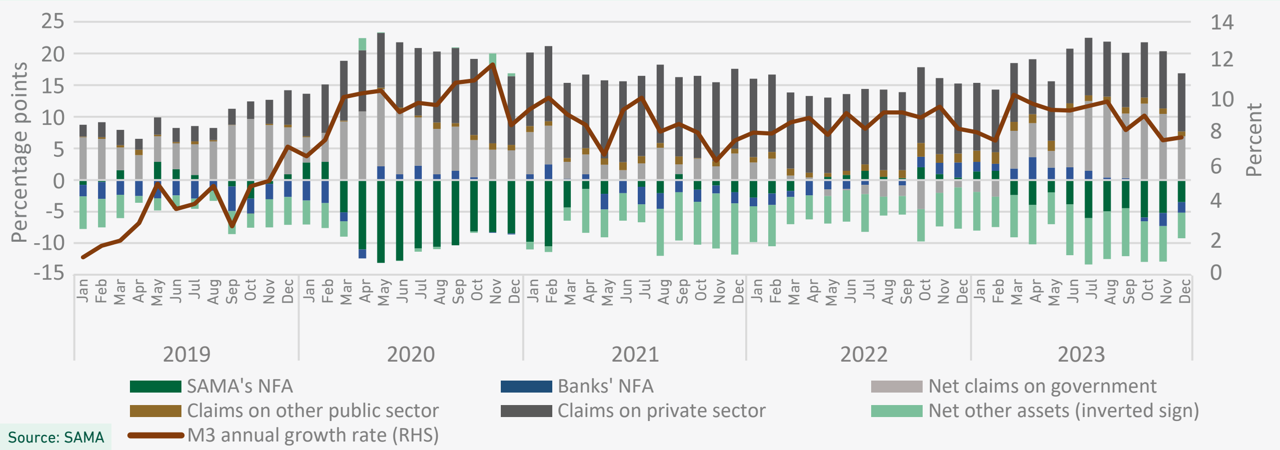
Source: GASTAT

Monetary conditions in 2023 remained supportive despite higher interest rate environment.

Broad money supply (M3) recorded robust growth of 7.6%, equivalent to SAR 190 billion in 2023, despite the increase in interest rates. The money supply counterparts show that net domestic assets (NDA) were the main drivers of M3 growth, contributing 12.8 percentage points, while net foreign assets declined by 7.4 basis points (Chart 2.5). Looking at the factors behind NDA growth, claims on the private sector contributed 9.2 percentage points, net claims on government contributed 6.9 percentage points, and claims on other public sector enterprises contributed 0.8 percentage points. The 4.1 basis points growth of net other assets had a negative impact on NDA.

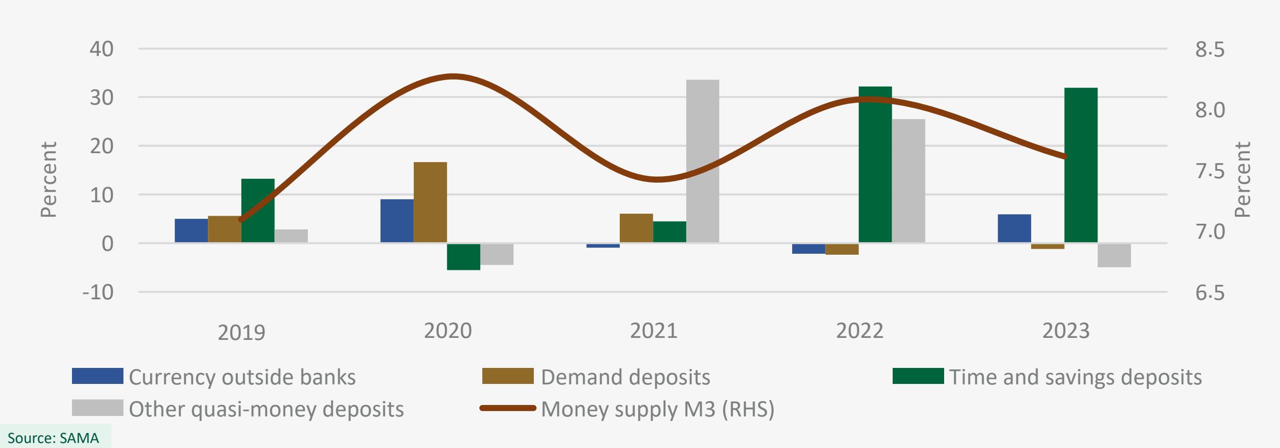
Total bank deposits increased by 7.8% in 2023. Deposit decomposition reveals that time and saving deposits grew by 32% in 2023, constituting around 32.2% of money supply, the highest share since 2008. The higher interest rate environment encouraged depositors to shift from non-interest-bearing deposits to time and saving deposits. Demand deposits and other quasi-money deposits decreased by 1.2% and 4.9%, respectively. Additionally, currency outside banks grew by 6% in 2023 compared to a decline of 2.2% in 2022 (Chart 2.6).

Chart 2.5: Contribution of M3 Counterparts to Annual Growth



Source: SAMA

Chart 2.6: Growth Rates of M3 and Its Components



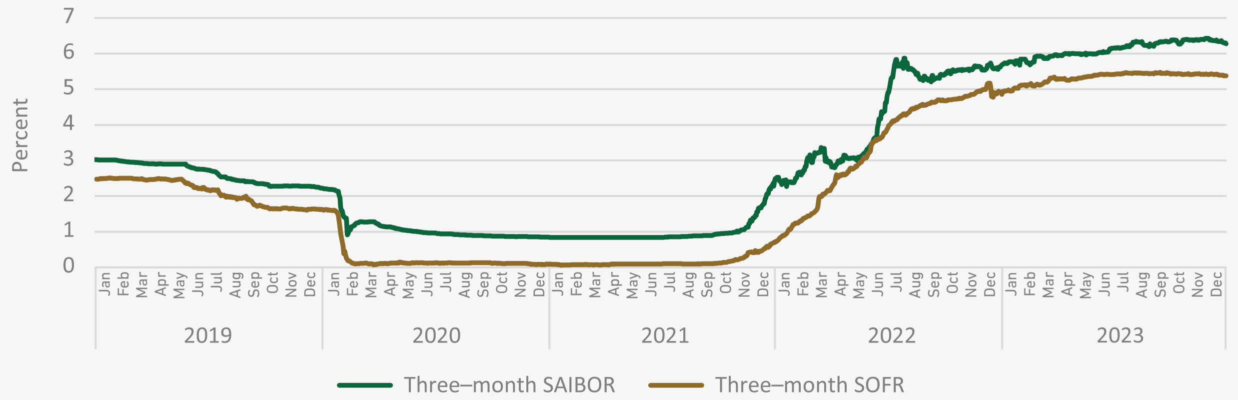
Source: SAMA

Saudi economic and financial conditions remained stable despite the rise in policy rates.

Following the rapid increase in US federal fund target rates in 2022 in an effort to contain inflationary pressures, the Fed raised the federal fund target rate to 5.25%–5.5% in 2023. To maintain monetary stability, the Saudi Central Bank (SAMA) raised the policy rates four times in 2023 to reach 5.5%–6%. The three-month Saudi Arabia Interbank Offered Rate (SAIBOR) averaged around 5.9% in 2023, implying a differential rate of 76.6 basis points to the three-month Term Secured Overnight Financing Rate (Term SOFR) (Chart 2.7). Despite the rise in SAMA's policy rates, market interest rates increased at a slower pace, reflecting stable monetary conditions.

Effective management of liquidity levels supported the economic and financial conditions. Excess liquidity[5] levels averaged around SAR 50.2 billion in 2023 compared to SAR 55.9 billion in 2022, underscoring the adequate liquidity conditions that prevailed throughout the year.

Chart 2.7: SAIBOR and Term SOFR



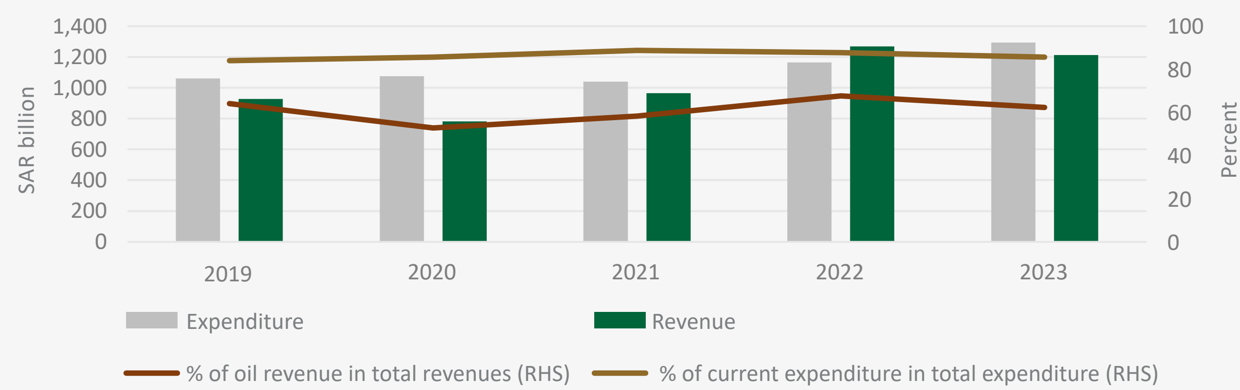
Source: SAMA, Bloomberg

Despite the decline in oil revenues, the Saudi Vision 2030 programs, which support the non-oil sector and diversify income sources, played an important role in raising non-oil revenues.

In 2023, government revenue decreased by 4.4% compared to the previous year to reach SAR 1,212.3 billion. This was due to the 12% decline in oil revenue as the Kingdom reduced oil output in an effort to stabilize the global oil market. On the other hand, non-oil revenues grew by 11.4% to SAR 457.7 billion, accounting for 37.8% of total revenues, which reflects the ongoing improvement in economic activity and the positive impact of the initiatives undertaken by the government to increase sources of non-oil revenue.

Government expenditure increased to SAR 1,293.2 billion in 2023, growing by 11.1% during the year, where capital expenditure and current expenditure rose by 30% and 8.4%, respectively. The focus on capital expenditure reflects the government's priorities in diversifying the economy and directing spending toward projects that contribute to sustainable non-oil economic growth (Chart 2.8).

Chart 2.8: Revenues and Expenditures

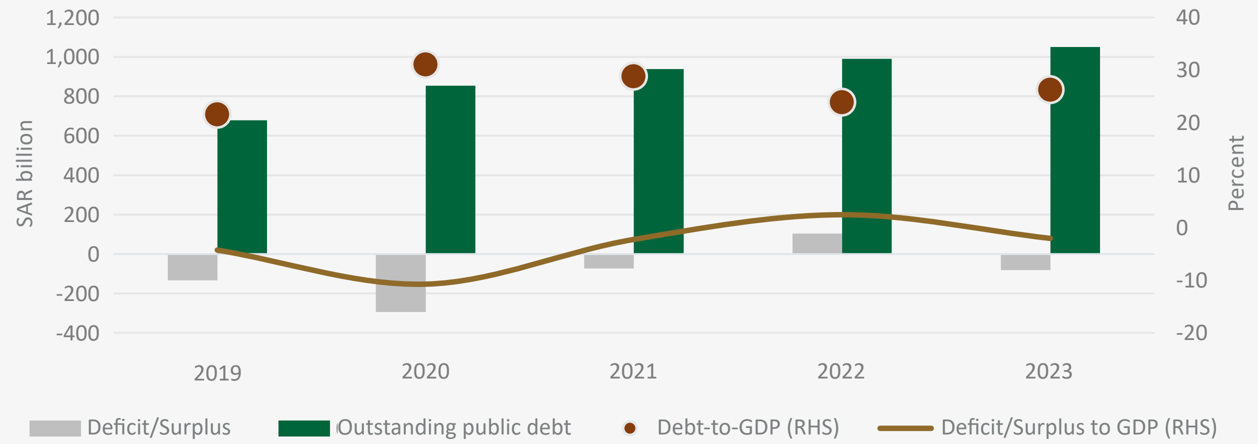


Source: MOF

[5] Excess liquidity = net reverse repo operations + outstanding SAMA bills.

Saudi Arabia recorded a budget deficit of SAR 80.9 billion in 2023 compared to a surplus of SAR 103.9 billion in 2022. Public debt increased in 2023 to reach SAR 1,050.3 billion. The debt-to-GDP ratio increased from 23.8% in 2022 to 26.2% in 2023, but remained below 2020 and 2021 levels (Chart 2.9).

Chart 2.9: Fiscal Developments

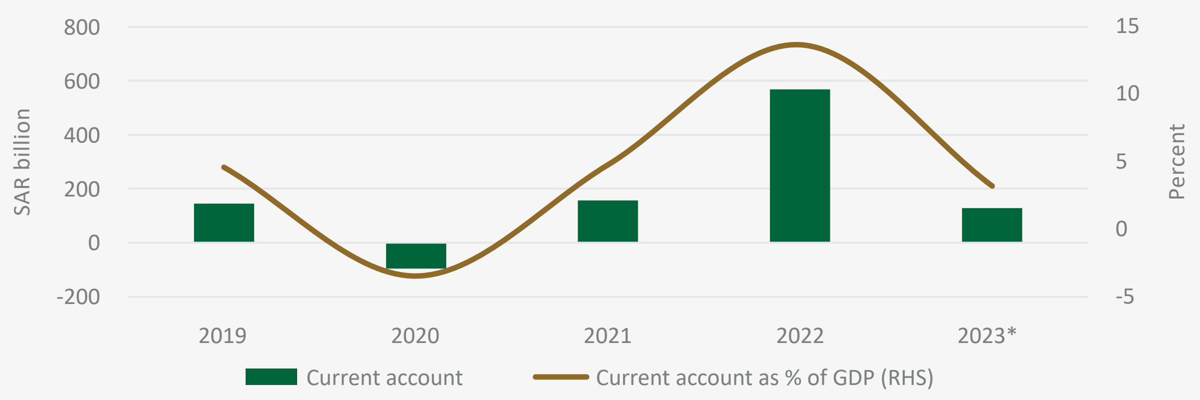


Source: MOF

Despite the fiscal deficit, the Kingdom recorded a current account surplus. The surplus coincided with a historical increase in the travel account in light of the Kingdom's efforts in improving tourism activities.

During the past five years, the current account has mostly registered surpluses, constituting on average 4.5% of GDP. Despite the increase in imports and decline in oil receipts, the current account recorded a surplus of SAR 128 billion in 2023 (equivalent to 3.2% of GDP) compared to a surplus of SAR 568 billion in 2022 (equivalent to 13.7% of GDP) (Chart 2.10). The services balance registered a deficit equal to 4.4% of GDP, notably lower than the pre-pandemic level of 6.5%, having been ameliorated by a surplus in the travel account.

Chart 2.10: Current Account



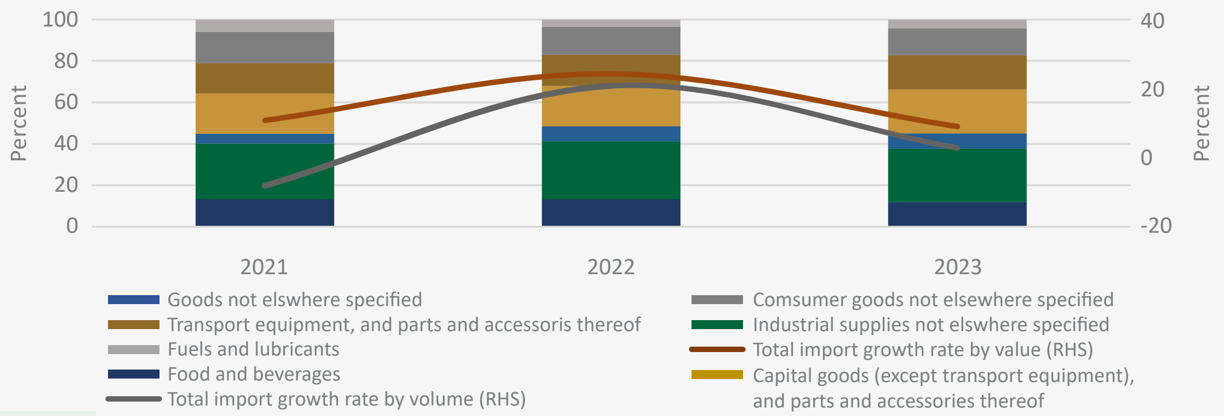
Source: SAMA, GASTAT

*Preliminary

The current account surplus narrowed in 2023 due to import demand and lower exports.

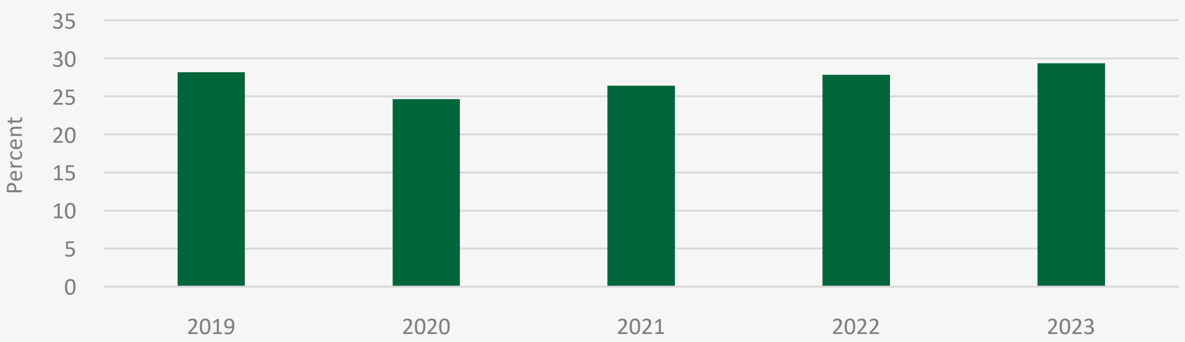
The 24% decline in oil exports, coupled with sustained demand for imports, impacted the 2023 trade balance. Despite a modest deceleration in the growth rate of imports (Chart 2.11), the share of imports relative to domestic final demand has risen steadily over the past four years (Chart 2.12).

Chart 2.11: Composition of Imports and Import Growth Rates by Volume and Value



Source: GASTAT

Chart 2.12: Imports to Final Domestic Demand

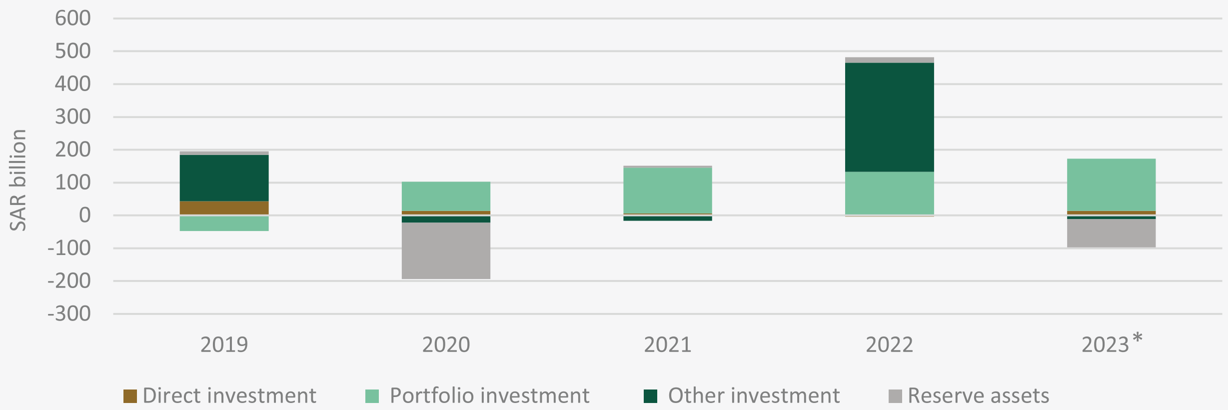


Source: SAMA Analysis

Note: Imports include goods and services.

The financial account registered a net outflow of SAR 75.6 billion by the end of the year. The flow of foreign assets was mainly through forms of direct investment and portfolio investment abroad (Chart 2.13). SAMA's foreign exchange reserves declined by 5% by the end of 2023, though they remain sufficient to meet the needs of the domestic economy.

Chart 2.13: Financial Account



Source: SAMA

*Preliminary

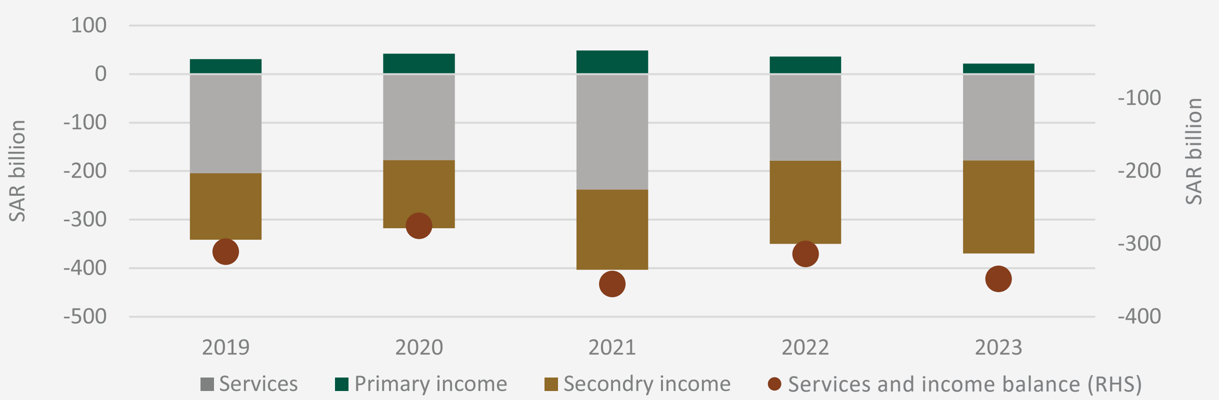
Box 2.1: Further Diversification of Current Account Inflows through Tourism

Tourism-related initiatives guided by Vision 2030 have begun to positively impact Saudi Arabia's external position. The greater inflows via travel receipts contribute positively to the current account. The current account has historically been impacted by Saudi Arabia's oil sector, as oil exports constitute a significant component of the current account.

The goods balance is the main component of the current account and has consistently shown significant surpluses, with an average of SAR 457.2 billion over the past 10 years. In 2023, the goods balance recorded a surplus of SAR 475.9 billion compared to a surplus of SAR 882.3 billion in 2022. This reduction was mainly due to the 24% decline in oil exports and the 11.2% increase in the imports of goods, as the latter reflects the acceleration of Vision 2030 projects and the continued increase in domestic demand.

Services and income are sub-accounts that represent intangible items within the current account. The largest movements in these sub-accounts have historically been associated with services and outflows of workers' remittances. In 2023, the total transactions of these sub-accounts recorded a deficit of SAR 348.1 billion compared to SAR 314.2 billion in 2022 (Chart A). The increasing gap in secondary income resulting from higher government aid and lower primary income was the main reason for the widened deficit in 2023, which outweighed the improvement in the travel account. The deficit in the total of these sub-accounts is expected to narrow further, supported by the surge in travel receipts, as tourism continues to grow into an important sector in Saudi Arabia's economic-diversification efforts.

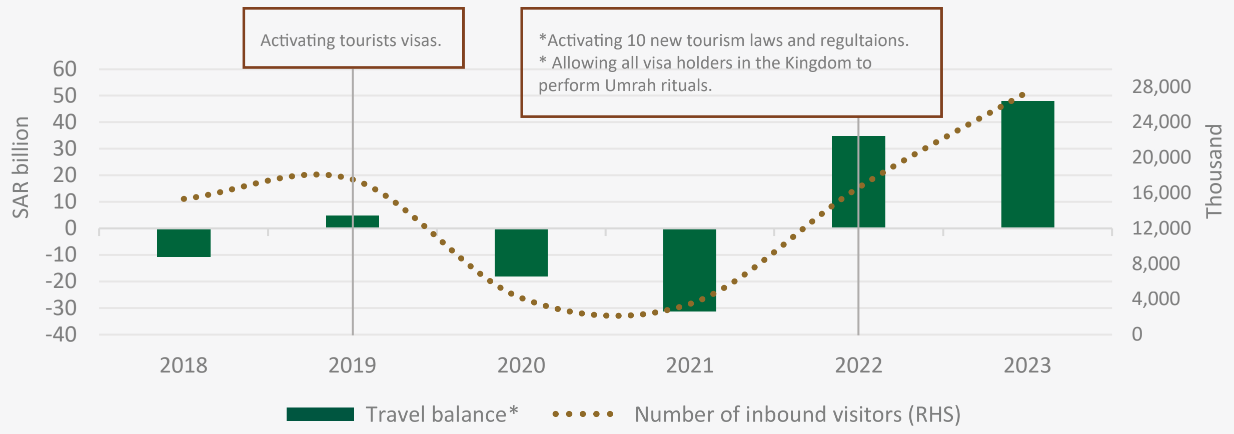
Chart A: Services and Income Accounts



Source: SAMA

The travel account balance recorded an annual increase of 37.8% to reach SAR 48 billion in 2023, with visitors spending around SAR 135 billion, reflecting the diversification of the current account and the overall economy (Chart B). Changes in regulations, such as easing of visa restrictions and modified tourism administrative procedures, continued to contribute to the expansion of the tourism sector. The number of inbound visitors increased significantly by 64.8% by the end of 2023.

Chart B: Travel Account Balance



Source: SAMA, the Ministry of Tourism

*2023 data is preliminary.

Box 2.2: National Financial Stability Committee

Financial stability is one of the key priorities in the development of Saudi Arabia's financial sector. Robust coordination among public entities contributes in ensuring that all dimensions of this objective are well captured. An important enabler is the National Financial Stability Committee (NFSC), established in 2015 to coordinate and facilitate cooperation among the major authorities in the Saudi financial system. The NFSC serves as the primary channel for addressing national financial stability matters and detecting emerging financial vulnerabilities across sectors.

The NFSC is an advisory committee and includes members from the Ministry of Finance, the Saudi Central Bank, the Capital Market Authority, the Insurance Authority, and the National Debt Management Center. Subcommittees were established to support the work and ensuring the quality and efficiency of the technical and administrative aspects of the NFSC. The Preparatory Committee serves to provide a layer of quality assurance and offers direction to the Technical Committee, which is mandated with the development of material and studies for the NFSC.

The NFSC recommendations are delivered in the form of studies and assessments that align with international best practices to ensure safeguarding and enhancing the financial system's stability.

Box 2.3: Macrofinancial Developments of Climate-Related Issues

Given the increased consideration of climate-related financial risks across different geographies and sectors, it is important to identify potential financial-risk amplification channels and their associated systemic implications. However, significant efforts are required to not only assess the risks of individual financial institutions but also to consider the transmission channels and interactions between the climate-risk drivers, the real economy, and the financial sector.

The Kingdom is developing policies in a holistic manner to guarantee optimal GHG-emission reduction, abatement, and removal without restraining ongoing economic development and economic-diversification efforts. This has cascaded to the financial sector in terms of the risk management and voluntary financing of ambitious climate-mitigation and climate-adaptation plans required to reach the national net-zero goal by 2060. The Kingdom aims to achieve this through the Circular Carbon Economy (CCE) framework, one of the main initiatives endorsed by the G20 leaders at the 2020 Riyadh Summit, to utilize all available solutions. Efforts are underway to stimulate private investment in order to support the framework. The CCE provides a holistic, flexible, and pragmatic framework for countries to plan their respective contributions to the shared climate objectives.

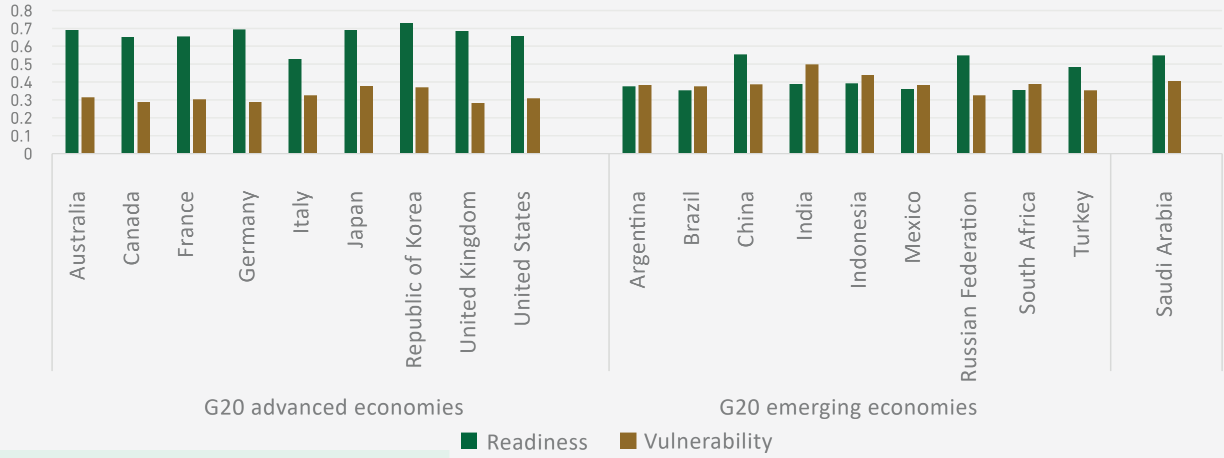
Domestically, the country's commitment to the environment and its transition pathway have had a ripple effect on other important actors in both the public and private sectors, instigating them to set voluntary emission-reduction targets. Encouraged by the Saudi and Middle East Green Initiatives, which were set to achieve climate and broader environmental objectives (e.g., adaptation, adaptation with mitigation co-benefits, ecosystems protection), a series of initiatives have been developed by the public and private sectors. The Public Investment Fund (PIF) is a founding member of One Planet Sovereign Wealth Funds Network, a group of global investors who aim to accelerate integration of financial risks and climate-change opportunities in the management of large, long-term asset pools. The PIF successfully issued a total of USD 8.5 billion in green bonds between October 2022 and February 2023. One of the tranches was for a 100-year maturity, reflecting the limited sovereign risks and positive investor outlook on the Kingdom's sustainable future.

As for the Kingdom's position, according to the ND-GAIN index,[6] which measures overall climate readiness through the lens of three components — economic readiness, governance readiness, and social readiness — Saudi Arabia is well positioned to withstand climate change, as it has witnessed decreasing vulnerability and increasing readiness over the years (Chart C).

Nonetheless, potential climate-related financial risks may arise over time. The transmission channels of relevant financial risks may be amplified by macrofinancial feedback loops and second-round effects, which are areas of ongoing research. The main financial stability risks include credit risks and, to some extent, market risks, which have been the focus of joint research efforts at the international level, such as the Financial Stability Board (FSB).

[6] The Notre Dame Global Adaptation Initiative's (ND-GAIN) Country Index is an open source index that shows a country's current vulnerability to climate disruptions. It also assesses a country's readiness to leverage private and public sector investment for adaptive actions.

Chart C: ND-GAIN Index



Source: ND-GAIN Index, updated in March 2023 for data until 2021

SAMA is accordingly working to further enhance its approach to understand, monitor, and assess the nature of climate risks and how such risks may evolve. SAMA is a member of the Network for Greening the Financial System (NGFS), which aims to identify and advance best practices for improving the financial sector's risk management and directing investments to sustainable, low-emission initiatives while meeting the goals of the Paris Agreement. SAMA is exploring NGFS's various scenarios and has conducted a comprehensive benchmarking exercise on fellow members' adoption and execution of related or nationally tailored scenarios and stress tests. These are usually grouped into orderly transitions, disorderly transitions, hot-house world scenarios, and too-little-too-late scenarios. The modifications in scenarios demonstrate that while it is useful to consider the requirements to reach net-zero by mid-century at the global aggregate level, it is equally important to consider the principles and circumstances of developing countries, including their respective timelines to reach net-zero.

Noting that energy prices and implied volatility have recently moderated, global and local reforms are underway to address emissions from the energy sector to mitigate climate change and build resilience while maintaining energy security and reducing its stability risks. Climate and energy policies, in addition to technological developments, warrant analysis based on whether they are demand-driven or supply-driven shocks, since energy prices will differ and have different macrofinancial implications. Several literature findings have established that the higher the energy insecurity, the more likely that macroeconomic efficiency would be adversely affected. Such effects include higher costs of raw materials, which would lead to costly production, and eventually higher inflation. This indicates that gradual and appropriate policy choices are needed to safeguard energy stability and security.

In this regard, SAMA reiterates its commitment to its objective of maintaining monetary stability and supporting financial stability. This is while endorsing the view that prudential regulation and supervision are supportive of the primary role of the central government regarding its policy for climate change, in line with its mandate by developing monitoring approaches and ensuring active engagement nationally and internationally.

3

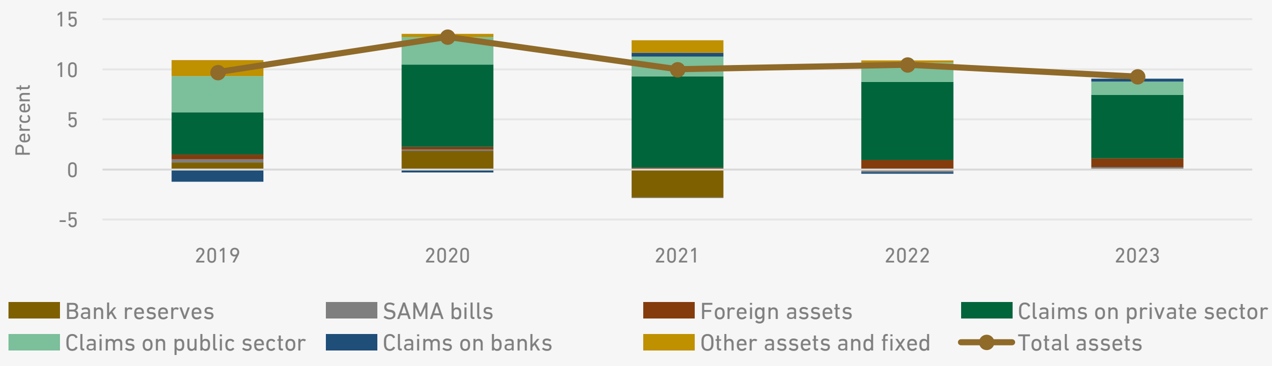
Banking Sector

3. Banking Sector

In line with non-oil GDP growth, banks' assets continued to grow, driven by private sector credit growth.

Total assets in the banking system grew by 9.3% at a slower pace compared to the growth rate in 2022, to reach SAR 3,957 billion. The majority of the growth was mainly attributed to the growth in claims on private sector, which accounted for 6.3% of total growth, in line with the GDP growth trend in the non-oil activities[7] (Chart 3.1).

Chart 3.1: Growth Drivers of Banking System Assets

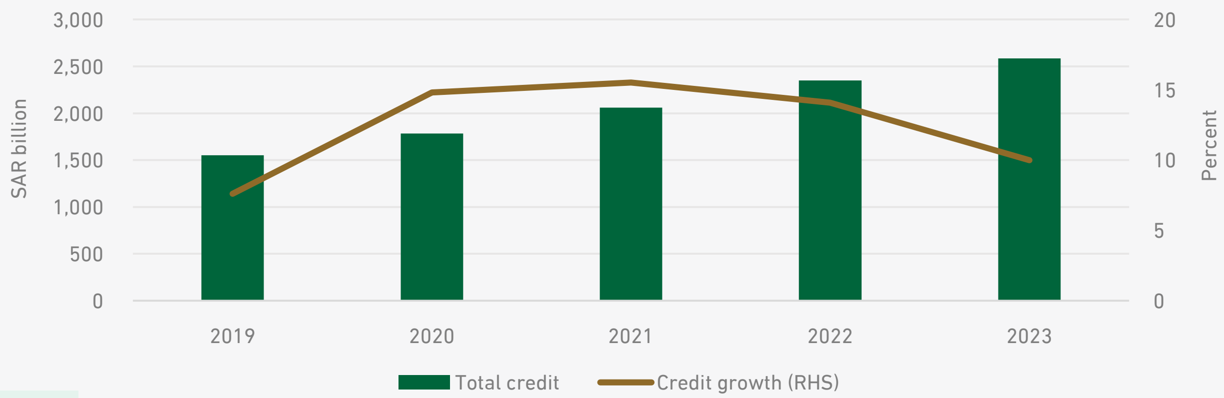


Source: SAMA

The banking sector continued to support the Kingdom's economic reforms through robust credit growth.

Banking sector credit increased by 10%, reaching SAR 2,584 billion in 2023 (Chart 3.2), supported by corporate real estate activities. There was a notable change in the composition of credit growth drivers, where credit growth was driven mainly by non-financial corporations. Individuals demand for mortgages remained solid; however, the growth in retail real estate lending began to plateau given that the growth rates witnessed in 2019–2022 came from a low base. Banking credit is anticipated to expand during 2024 and 2025. The primary underlying drivers are expected to be non-financial corporations, aligning with the expectations for continued growth in non-oil activities during 2024 and 2025. These expectations come partly from large infrastructure projects, where several projects, such as NEOM, the Red Sea and Qiddiya, have been driving significant capital investments.

Chart 3.2: Banking Credit Growth



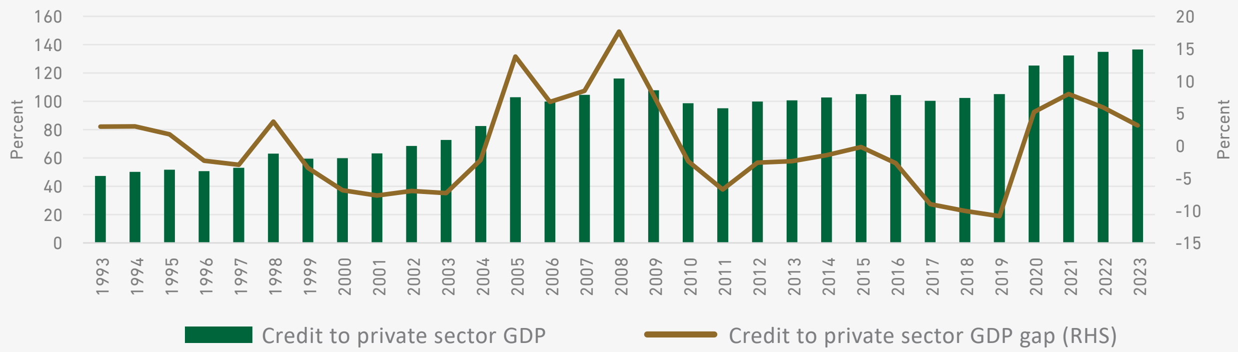
Source: SAMA

[7] Please refer to the Domestic Economy Chapter for further details.

Credit to the private sector continued to grow in line with private sector economic growth, as measured by the credit to private sector GDP gap.

A useful indicator to determine the buildup of vulnerabilities is a faster expansion in credit activities relative to economic activities, which can be measured as the difference between the current ratio of credit to GDP and its historical trend, otherwise known as the credit to GDP gap. In the KSA context, a multitude of factors are considered in addition to the gap, which is assessed by analyzing trends in total GDP and more importantly, private sector GDP (Chart 3.3). Private sector GDP is often more relevant, as total GDP tends to be impacted by oil market volatility, which impacts the trend in the gap ratio. The credit to private sector GDP ratio peaked in 2021 due to growth in mortgage activities, and since then the ratio has been trending down.

Chart 3.3: Credit to Private Sector GDP Gap

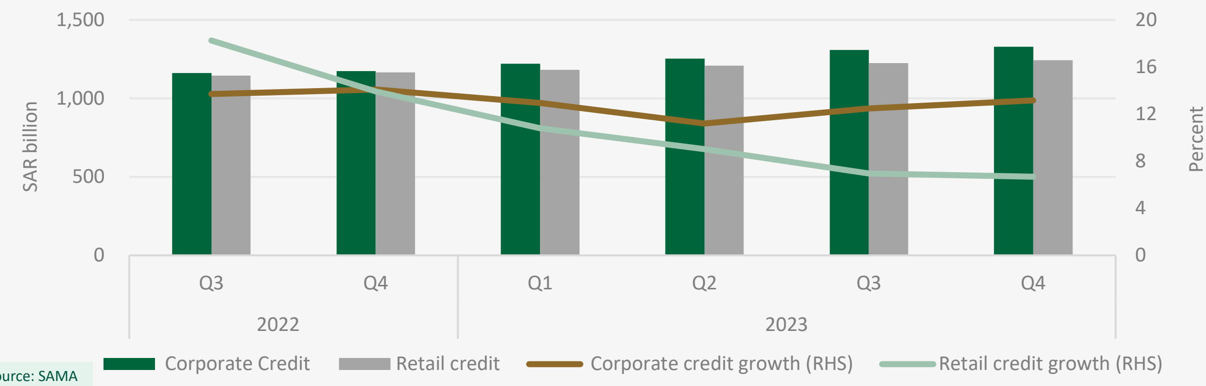


Source: SAMA, GASTAT, SAMA Analysis

In 2023, corporate credit recorded strong growth, driven by utilities and real estate activities, while the retail segment witnessed a continued deceleration.

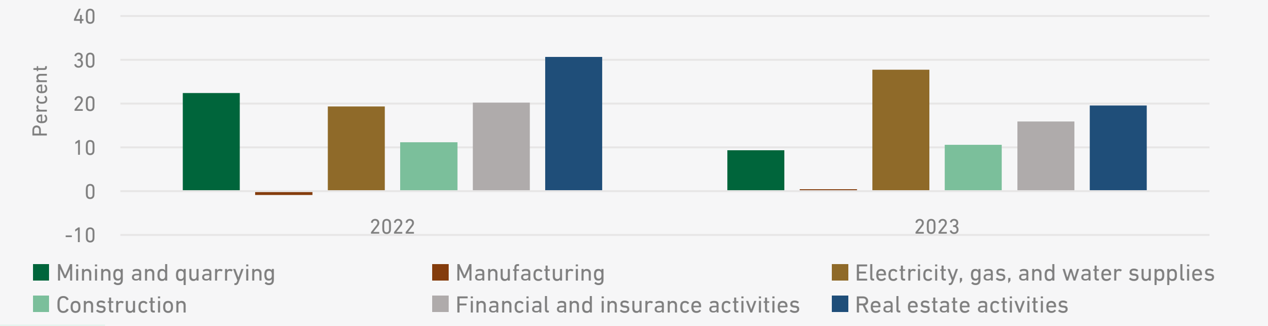
By the end of 2023, corporate credit was the primary driver of bank credit, increasing by 13.2% to reach SAR 1,329 billion (Chart 3.4). The growth was driven by utilities and real estate activities, which registered an increase of 27.8% and 19.6%, respectively, reflecting the expansion in non-oil growth (Chart 3.5). By contrast, retail credit grew by 6.7% in 2023, driven mainly by mortgages, which accounted for 48.8% of the total retail credit (Chart 3.6).

Chart 3.4: Credit Volume and Growth by Sector



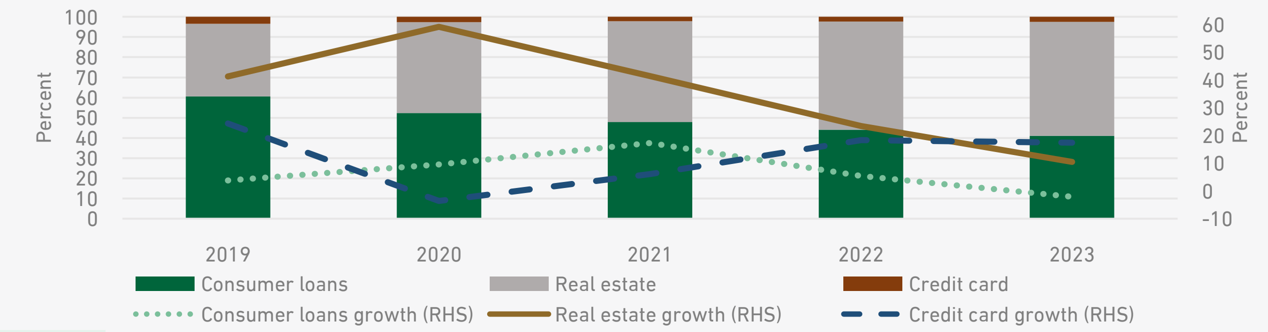
Source: SAMA

Chart 3.5: Corporate Credit Growth for Selected Economic Activities



Source: SAMA

Chart 3.6: Retail Credit Contribution and Growth Rate by Type



Source: SAMA

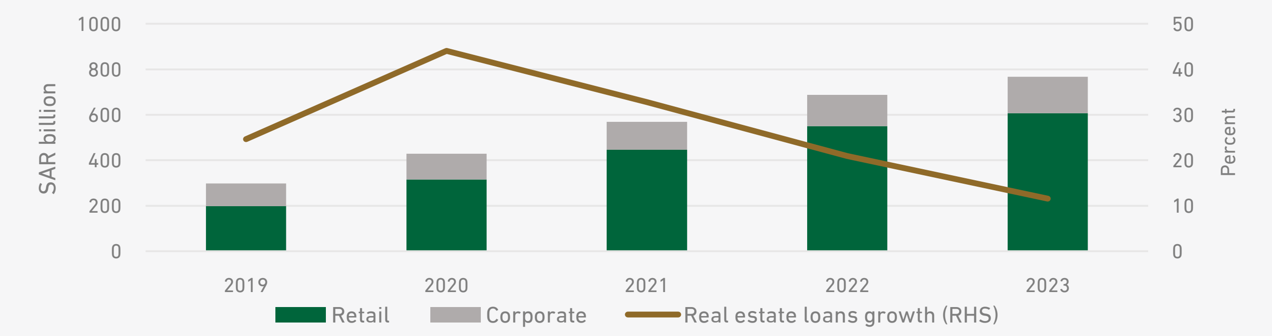
Real estate loans continued to grow, albeit at a slower pace with a shift to corporate real estate lending by the end of the year.

Total bank real estate loans grew by 11.5 % in 2023, reaching SAR 767 billion, compared to the 20.9% growth rate in 2022. Retail real estate loans, which represented 79.1% of total real estate loans, increased by 10.4% in 2023 compared to 23.3% in 2022. However, real estate loans provided to the corporate sector increased by 15.9% compared to 12.1% in 2022 (Chart 3.7). The share of real estate credit continued to increase, reaching 29.7% in 2023 compared to 16.5% in 2018. This was due to government initiatives to support the homeownership goals, which reached 63.7% by the end of 2023.[8]

The Saudi banking system continued to play an important role in financial intermediation and maturity transformation, which resulted in higher long-term assets relative to their long-term liabilities profile. While retail non-interest bearing deposits remain a core funding component of the banking system, there has been notable growth in banks' long-term sources of funding, particularly through the recent debt issuances by banks which help reduce maturity mismatch risks.

[8] Source: Vision 2030 Annual Report 2023.

Chart 3.7: Total Real Estate Loans



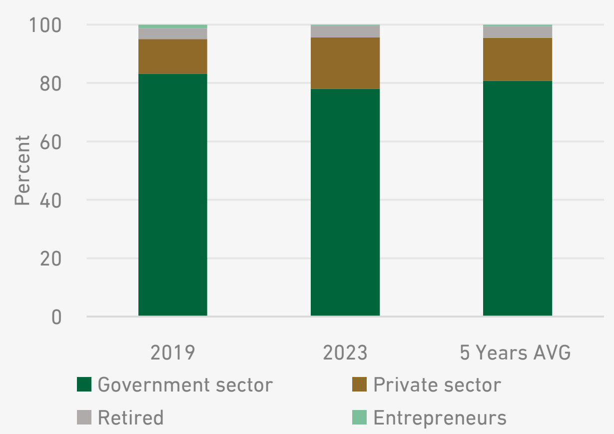
Source: SAMA

There has been a greater distribution of retail real estate loans across different segments, and risks remain contained.

The limited risks in retail mortgages is due to effective prudential measures and the type of exposures, such as mortgages being issued with full recourse, with a unified mortgage contract, and salary assignment, with borrowers mostly from the public sector. The prospective loss of the housing subsidy in the event of default also served as a further disincentive against defaults. In addition, 85.9% of total retail real estate loans were at a fixed-rate, thus mitigating the impact stemming from interest rate changes.

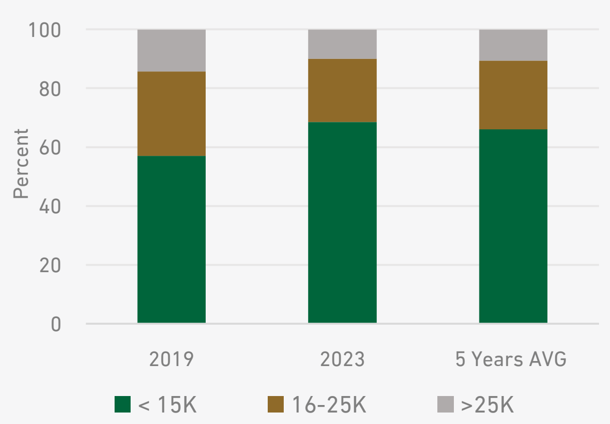
Evidence of the success of the government's initiatives to support homeownership is showcased in an increase in the size of retail real estate loans being directed to both private sector employees, and individuals with incomes less than 15,000 in the private and public sectors. (Chart 3.8) and (Chart 3.9). Risks are mitigated through SAMA's comprehensive macroprudential framework, which includes responsible lending principles, credit risk management and loan-to-value (LTV) cap.

Chart 3.8: Real Estate Lending Based on Occupation



Source: SAMA

Chart 3.9: Real Estate Lending Based on Monthly Income (SAR)

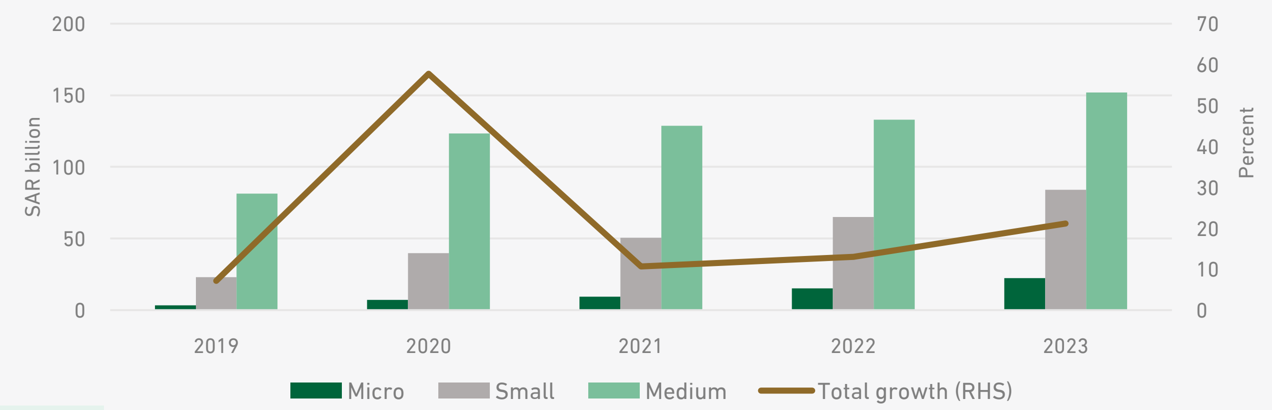


Source: SAMA

Credit demand from micro, small and medium enterprises is expected to expand further in 2024, due to favorable prospects for non-oil growth and government support.

Total bank credit extended to micro, small and medium enterprises (MSMEs) grew by 21.1% in 2023, reaching SAR 258 billion (Chart 3.10). Efforts to support MSMEs by improving access to credit and providing loan guarantees through programs, such as the small and medium enterprises loan guarantee program (Kafalah) and the Financial Sector Development Program (FSDP) are expected to continue in 2024.

Chart 3.10: Banks' credit to MSMEs

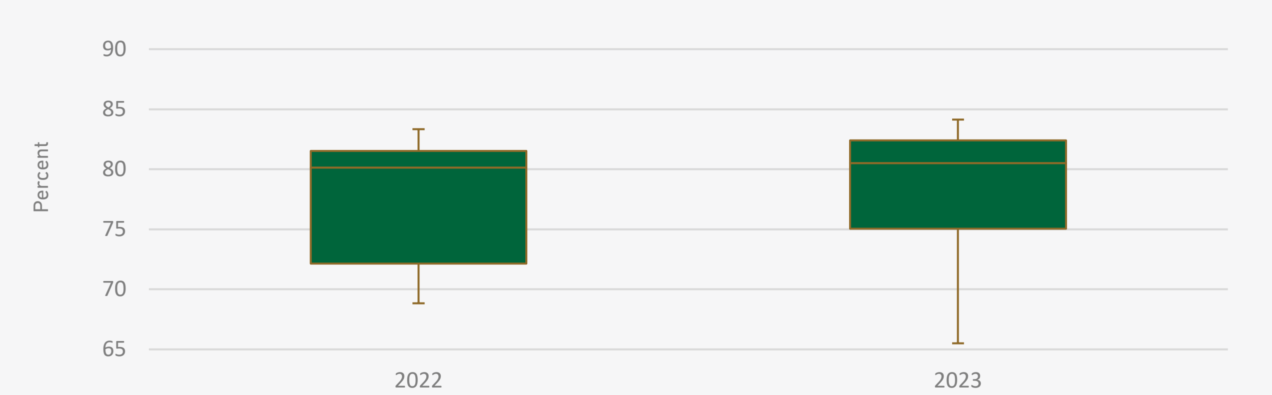


Source: SAMA

Banks' lending capacity remained adequate to support credit demand.

The median loan to deposit ratio (LDR) for domestic banks, which reflects banks' lending capacity, increased slightly to 80.5% in 2023 compared to 80.1% in 2022, but remained below the SAMA guideline of 90% (Chart 3.11). The LDR methodology was updated in June 2023 to allow banks to include long-term debts in addition to deposits, which is expected to support diversification of banks' funding sources.[9]

Chart 3.11: Boxplot of Domestic Bank's LDR



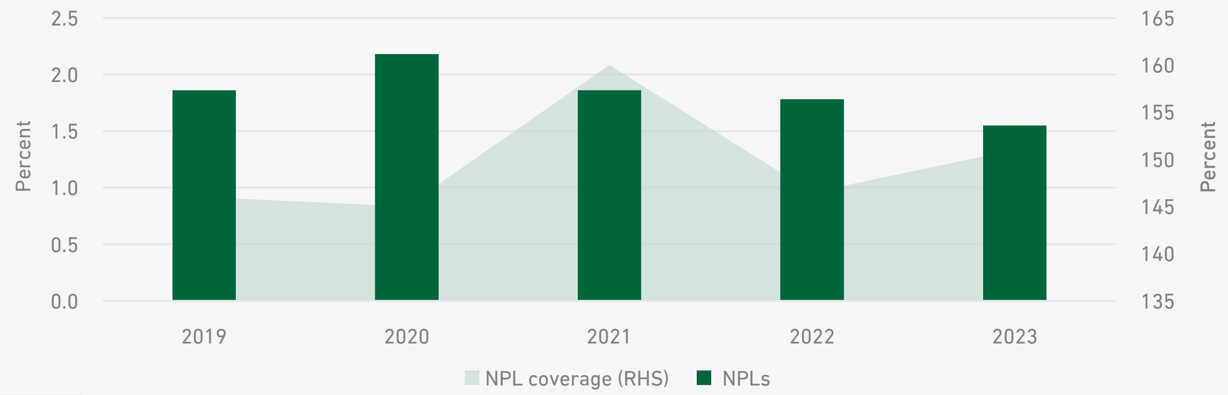
Source: SAMA

[9] Loans to Deposits Ratio Guidelines provide further details.

Asset quality remained strong, with a low level of non-performing loans.

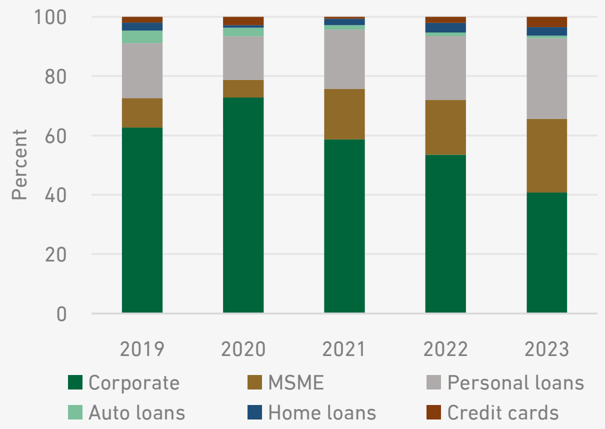
The overall non-performing loans (NPLs) ratio has shown a consistent decline since 2020, reaching 1.5% in 2023 compared to 1.8% in 2022, partly attributed to the higher write-offs during the year, which may indicate that the banking sector maintains asset quality while sustaining a high level of profitability. Moreover, NPL provision coverage ratio reached 151% in 2023, reflecting a robust prudential position (Chart 3.12), (Chart 3.13), and (Chart 3.14).

Chart 3.12: NPLs



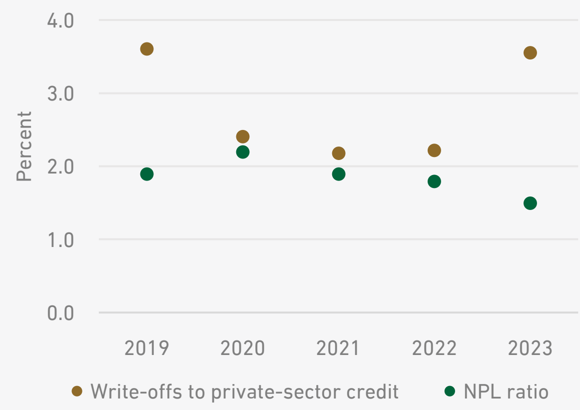
Source: SAMA

Chart 3.13: Composition of Write-Offs by Sectors



Source: SAMA

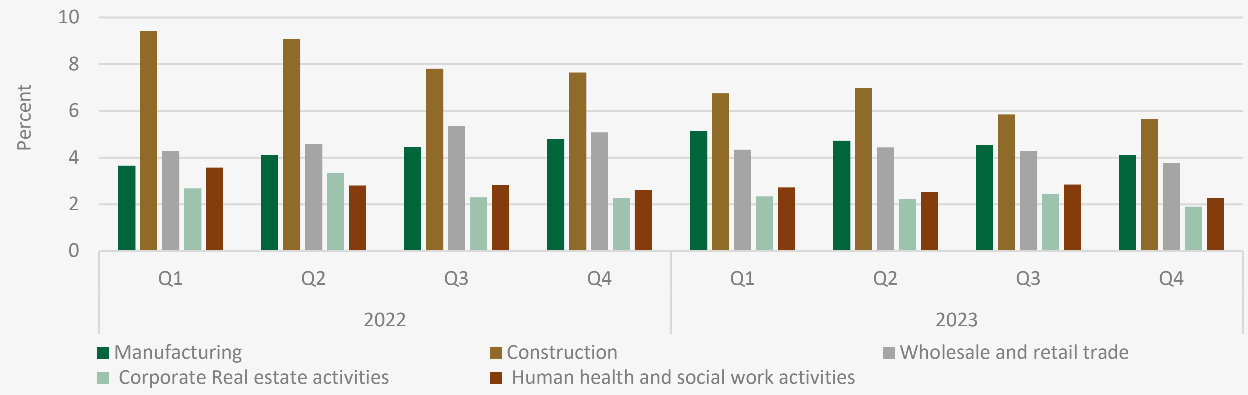
Chart 3.14: Write-Offs to the Private Sector and NPL



Source: SAMA

The decline in NPLs was broad-based and observed across all sectors. The sectors with the highest NPLs were construction, manufacturing, and whole and retail trade; where NPL rates were 5.7%, 4.1%, and 3.7%, respectively (Chart 3.15). Although the construction sector had the highest NPL ratio, it experienced a decline compared to the 2022 rate of 7.6%. This could be attributed to the improved financial position of the construction sector.

Chart 3.15: Sectoral NPLs for Selected Activities

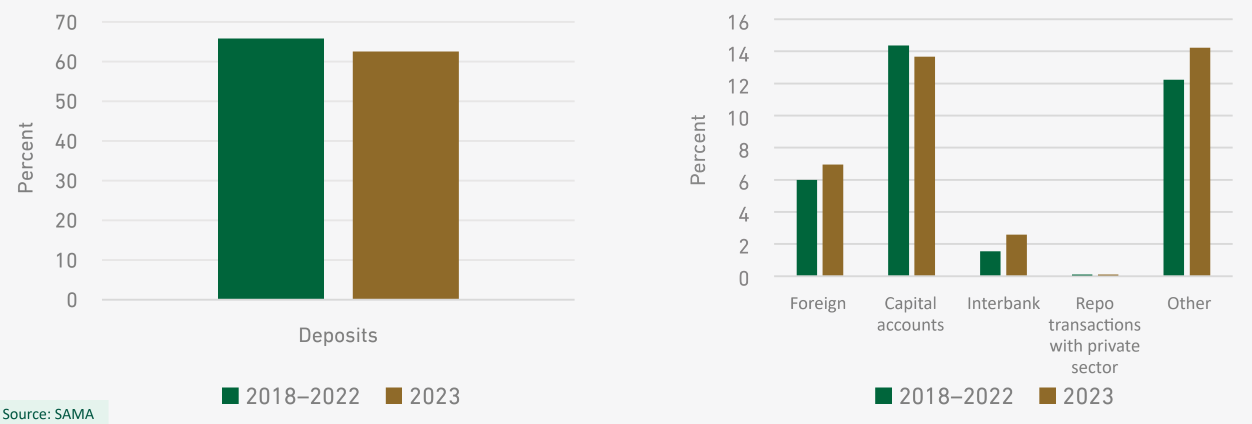


Source: SAMA

Deposits remained the primary funding source for the banking system.

The banking system's liability structure was supported by an increase in total deposits by 7.8%. The asset growth in 2023 was funded through a slightly different composition relative to the preceding five-year average, with a higher reliance on foreign and interbank funding. Deposits remained the primary funding source for the banking system, accounting for 62.5% of banks' liabilities (Chart 3.16).

Chart 3.16: Banking Liabilities Composition

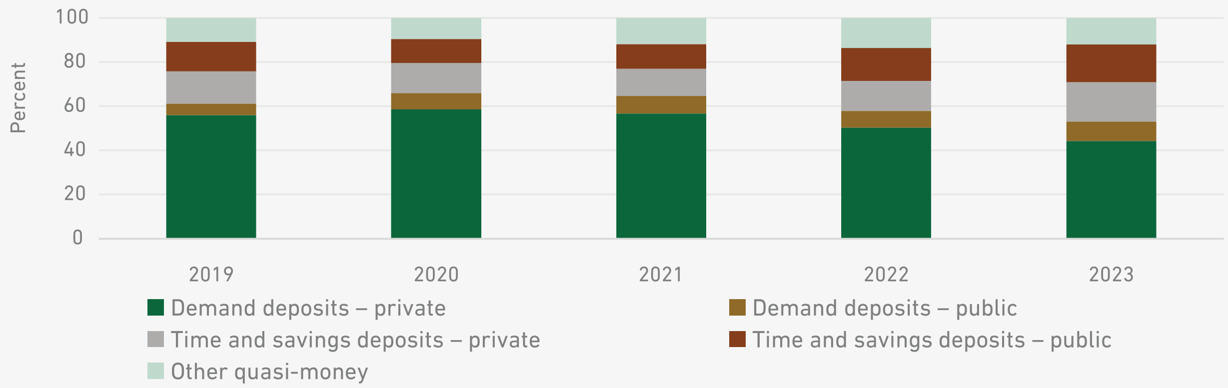


Source: SAMA

There was a notable shift toward time and savings deposits.

Data shows a change in the composition of time and savings deposits, where the share of businesses and individuals rose to 17.8% in 2023 compared to 13.7% in 2022. In contrast, demand deposits decreased by 1.2% in 2023, and their share of total deposits declined to 53.1% from 57.9% in 2022. This trend is attributed to the higher interest rate environment (Chart 3.17).

Chart 3.17: Deposits Composition

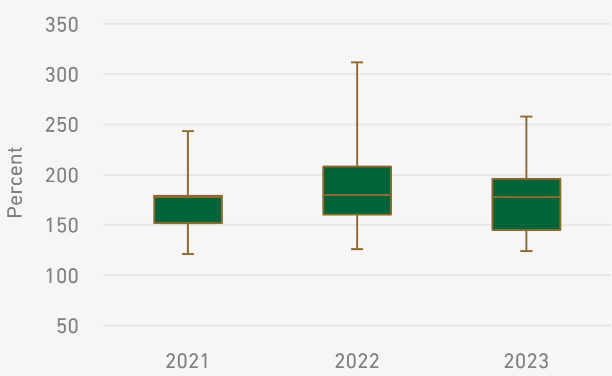


Source: SAMA

Liquidity ratios declined marginally but remained well above regulatory minimum requirements.

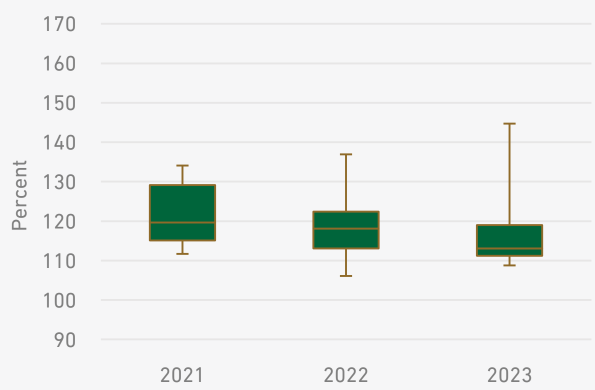
The sector's gross average liquidity coverage ratio (LCR) decreased in 2023 to reach 178% compared to 180.3% in 2022. Similarly, median LCR decreased to 177.6% in 2023 compared to 179.9% in 2022, due to a slight decline in high-quality liquidity assets (HQLA) and net outflows increased (Chart 3.18). While the gross average net stable funding ratio (NSFR) slightly decreased, reaching 113.3%, compared to 115.8% in 2022 and the median NFSR decreased to 113.1% compared to 118.1% in 2022 (Chart 3.19), it remained well above SAMA requirements. The decline in the NSFR was due to the increase in required stable funding driven by the expansion in mortgage.

Chart 3.18: Boxplot of LCR



Source: SAMA

Chart 3.19: Boxplot of NSFR

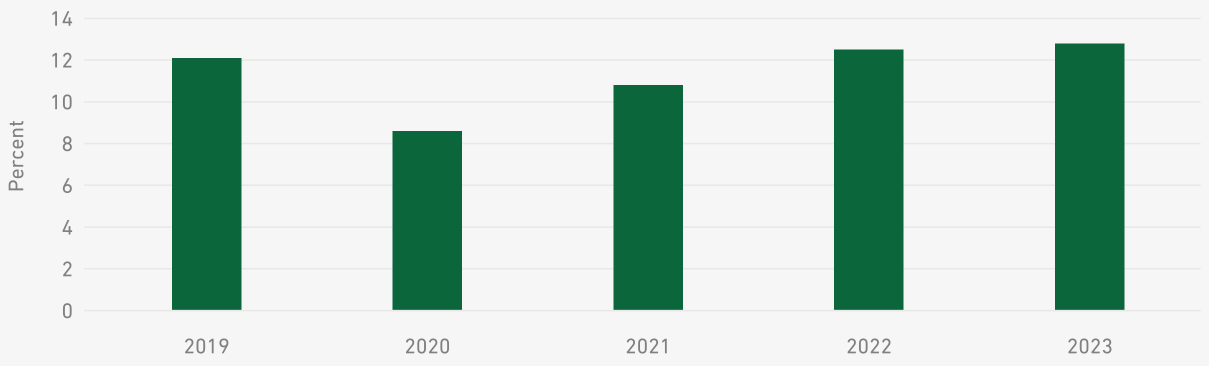


Source: SAMA

The banking sector's profitability continued to improve in 2023.

The banking sector saw improved profitability levels in 2023, driven by higher private sector credit demand and a higher interest rate environment, with the sector's return on equity (ROE) reaching 12.8% compared to 12.5% in 2022 (Chart 3.20).

Chart 3.20: ROE



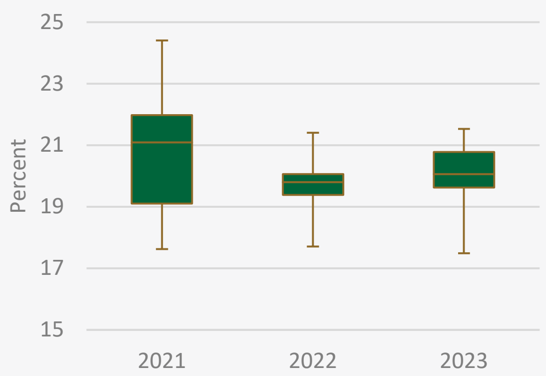
Source: SAMA

The banking sector remained well-capitalized.

Both gross banking system average and median capital adequacy ratio (CAR) increased to 20.1% in 2023 compared to 19.9% and 19.8%, respectively in 2022 (Chart 3.21). Tier 1 capital, which includes common equity and retained earnings, is the predominant capital, accounted for 92.2% of the banking system's capital base (Chart 3.22). Additionally, the growth in common equity exceeded the growth rate of risk-weighted assets (RWAs), contributing to improved solvency in the system.

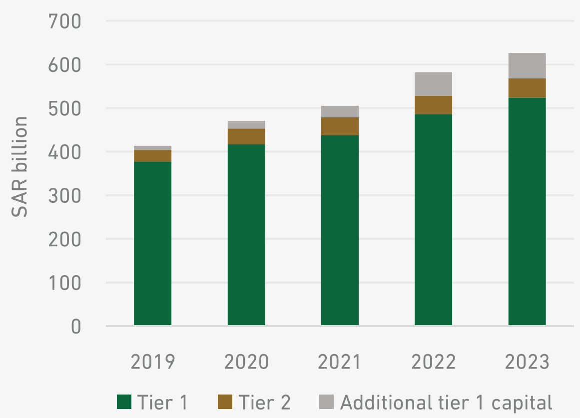
The growth in capital in the banking system was driven by enhanced profitability in addition to capital issuances by banks throughout the year to bolster their capital position. Despite an increase in total RWA of 6.5% in 2023, they comprised a smaller portion of total assets of the banking system, where the ratio of RWAs density assets decreased to 71.3% from 73.1% in 2022. This indicates that banks have shifted their new exposures to lower risk weights, which is consistent with the growth in the mortgage book of the banking sector (Chart 3.23).

Chart 3.21: Boxplot of CAR



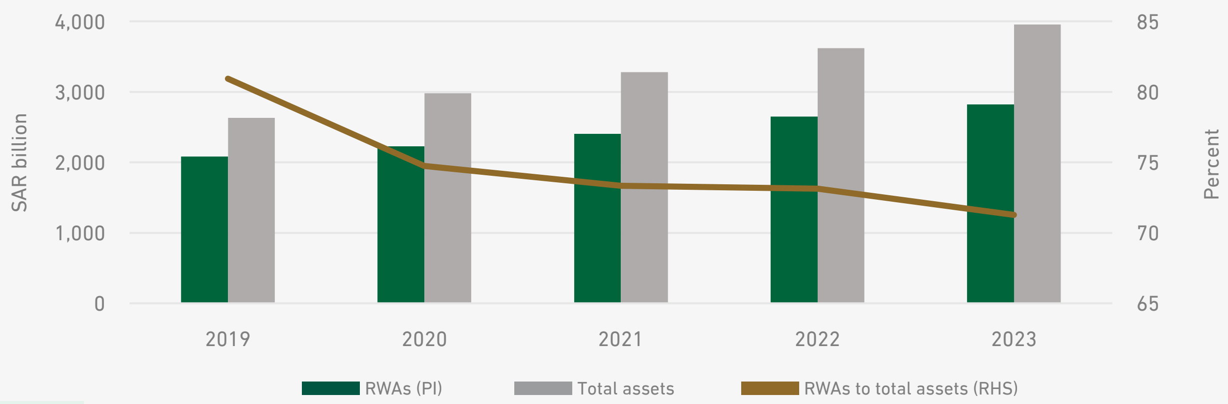
Source: SAMA

Chart 3.22: Tier 1 and 2 Capital



Source: SAMA

Chart 3.23: RWA and Total Assets



Source: SAMA

Box 3.1: SAMA's Macroprudential Policy Framework

In line with its statutory objectives in maintaining monetary stability, promoting the stability and enhancing confidence in the financial sector, and supporting economic growth, SAMA ensures effective and efficient implementation of macroprudential tools through a clear, consistent, transparent, and comprehensive framework. To achieve these goals, SAMA strives to ensure it has a robust framework in place that considers in-depth analysis of risk-impact assessment, stakeholders' perspectives, and a range of policy recommendations.

SAMA is the competent national authority responsible for defining macroprudential objectives and policies for entities under its remit to support the financial sector's stability. Operationally, macroprudential policy responsibilities are delegated to the Financial Stability Committee (FSC), chaired by SAMA Governor, whose members include representatives from all relevant SAMA deputyships. The committee meets periodically and is also convened in times of need. The FSC's primary goal is to support the financial sector's stability in the Kingdom and enhance confidence by establishing and managing macroprudential policies and implementing the necessary procedures and measures for financial institutions to help deal with local, regional, and international economic and financial developments.

SAMA's macroprudential framework is built upon a comprehensive analysis and best international practices that suit Saudi Arabia's context and is structured around three pillars to ensure its effectiveness. First, the decision-making process for macroprudential tools and policy is undertaken by the FSC to ensure robust oversight and alignment with SAMA's objectives and macroprudential policy principles. Second, internal coordination involves establishing a macro/micro subcommittee under the FSC that includes all relevant members. The subcommittee's role is to update and discuss macroprudential and microprudential policies to ensure alignment and comprehensive analysis of risk and vulnerability before FSC meetings. Finally, calibration and assessment rely on the analysis of macroeconomic and financial indicators, incorporating discretion, as opposed to relying on a rules-based approach to mitigate identified risks by thorough risk and vulnerability assessments. Additionally, the framework undergoes regular reviews to maintain its effectiveness in line with macroeconomic conditions and trends in the financial system.

Macroprudential tools and policies greatly overlap with microprudential policies and measures; their classification is based primarily on the use of such tools and the scope of implementation. A macroprudential use of the tools would be to address systemic risk and apply it to the entire financial system, while a microprudential use would be principles-based and address individual financial institutions.
The table below outlines the key macroprudential policies and tools implemented by SAMA.

No.	Tool	Regulatory Requirement
Macroprudential Tools		
1	Countercyclical capital buffer (CCyB)	Currently set at 0% of RWA.
2	Capital surcharges for domestic systemically important banks (D-SIBs)	The designation of D-SIBs and the determination of capital surcharges are undertaken on an annual basis. The capital surcharges range from 0.5% to 2.5%. In 2024, five Saudi banks were categorized as D-SIBs.
3	LDR	Banks should not exceed LDR of 90%.
4	LTV	– Mortgage loan for primary home of citizens: ≤ 90% of residential real estate value. – Other mortgage loans for citizens: o By banks: ≤ 70% of residential real estate value. o By finance companies: ≤ 85% of residential real estate value.
5	Debt service to income ratio (DSTI) Debt burden ratio (DBR)	The limit varies according to the customer's level of income and their total obligations. For details, see Responsible Lending Principles for Individual Customers.
Macro/Micro Overlap[10]		
1	Capital conservation buffer	2.5% of RWAs, to be met with CET1 capital.
2	General provisions	Set at a fixed level: 1% on net outstanding exposure.
3	Dynamic provisioning	Based on IFRS 9 requirements.
4	Leverage Ratio	For banks, two leverage ratios exist: – There is the Basel leverage ratio, a ratio of Tier 1 capital to total exposures, which equal a minimum of 3%. – Under the Saudi Banking Control Law, banks' deposit liabilities should not exceed 15 times of its reserves and invested capital. For finance companies: – Companies engaged in real estate finance activity, the aggregate finance amount offered shall not exceed five times the capital and reserves. – Companies engaged in other finance activities, the aggregate finance amount offered shall not exceed three times the capital and reserves. – Any excess to the above leverage limits are subject to SAMA non-objection.
5	LCR	Banks are required to maintain, at a minimum and on an ongoing basis, HQLA equal to 100% of projected net cash outflows over a 30-day stress period.
6	NSFR	Banks are required to maintain a stable funding ratio of at least 100% in relation to the composition of their assets on an ongoing basis.
7	Large exposures restrictions	– For banks, the limit varies according to the type and size of the counterparty. – For finance companies, the aggregate of large exposures must not exceed the paid-up capital and reserves of a finance company unless the finance company has obtained a non-objection letter from SAMA. Single Party Exposure is capped at 10% of paid up capital and reserves of a Finance Company, while Group exposure limit is set at 25% of paid up capital and reserves. Any excess to the above limits are subject to SAMA non-objection.

[10] Macroprudential: In cases when there is a system-wide cyclical adjustments or buffers.
Microprudential: In cases when there are no time-bound deviation in regulatory limits, or bank specific, impose the prudential minimum requirement.

4

Non-bank Financial Institutions

4.1 Finance Companies Sector

Finance companies experienced accelerated growth in total assets, surpassing 2022's pace.

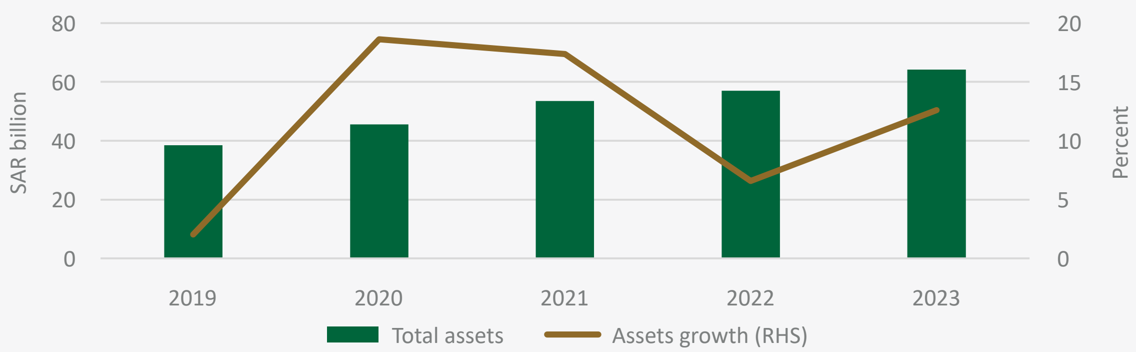
Total assets of finance companies increased significantly by 12.6% in 2023, reaching SAR 64.2 billion (equivalent to 1.6% of GDP). Despite this rapid growth, finance companies' total assets represent 1.6% of total banking assets, indicating their relatively modest size compared to the overall size of the banking sector's assets (Chart 4.1.1).

The pronounced growth in assets was driven primarily by an expansion in credit portfolios, particularly through short and long-term net investments in finance and non-finance lease products, which collectively comprised 86.5% of the total assets. The increase in total assets of finance companies demonstrates the positive externalities resulting from increased economic activity in the Kingdom, whether through financing for MSME activity or by providing financing to a broader range of retail consumers. The momentum generated by large-scale infrastructure projects and economic development initiatives underway in the Kingdom have also contributed to the growth of the broader financial sector.

SAMA is mindful that notable growth in the total assets of finance companies could also increase credit risk, largely through boosting their lending activities. SAMA is accordingly vigilant with regard to the performance of finance company asset portfolios and continuously reviews and enhances its regulatory and supervisory frameworks in responding to the changing risk environment in the finance companies sector.

Expanded credit extension by finance companies could increase liquidity risk as it could lead to an asset–liability mismatch, where long-term loans are financed by short-term liabilities. To safeguard against this, SAMA published its Rules on Liquidity Risk Management, which came into effect in January 2023. These rules aim to establish minimum standards for licensed finance companies and maintain a robust framework for managing liquidity risk under both normal and stressed conditions.

Chart 4.1.1: Total Assets Growth



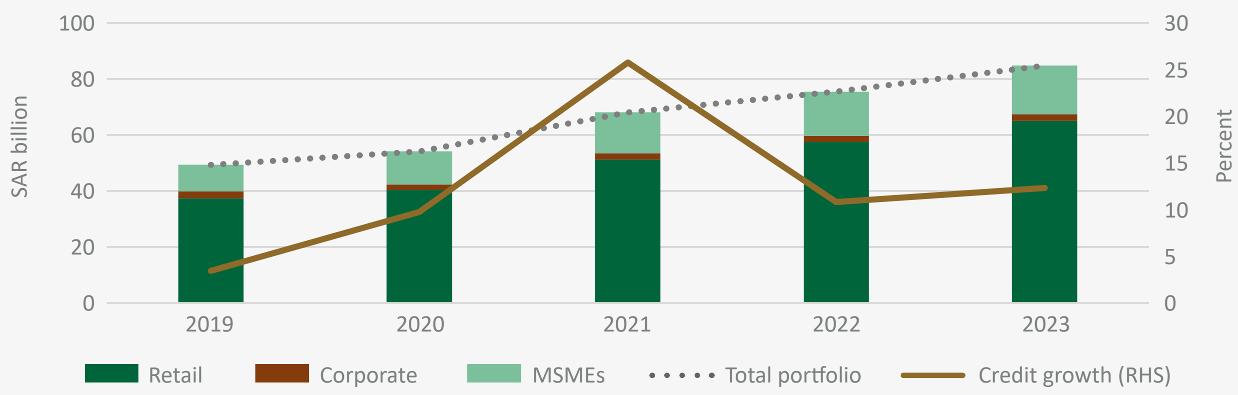
Source: SAMA

The retail sector drove credit expansion in Saudi finance companies.

Lending by finance companies increased, supporting the substantial growth observed in total assets, with a credit growth of 12.3%, reaching SAR 84.7 billion in 2023. The overall credit, on-balance and off-balance sheet, of finance companies is equivalent to 3.3% of the total banking sector's credit in 2023 (Chart 4.1.2).

Notably, retail lending dominated the net financing portfolio in 2023, representing 76.7% of the total portfolio, followed by the MSMEs sector at 20.4% and corporate sector financing at only 2.9%. These figures align with broader economic trends, including fostering of MSMEs development, promotion of financial inclusion, and expansion of financing options through government support programs, such as Kafalah and Tomoh programs. These government initiatives not only provide financial support, but also reduce the concentration risks associated with lending to large corporations by spreading credit exposure across a wider range of MSMEs.

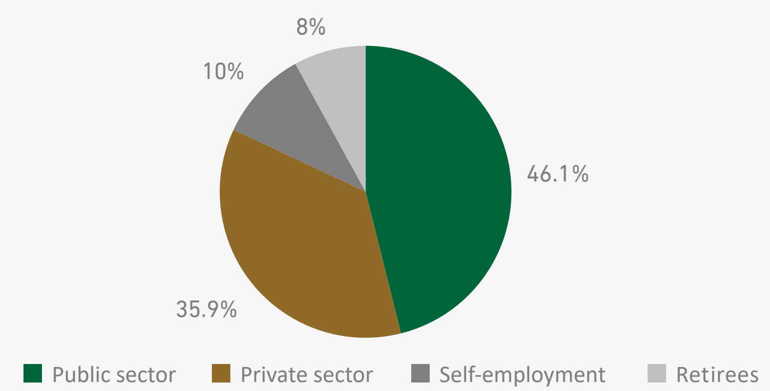
Chart 4.1.2: Total Credit Classified by Sector



Source: SAMA

Nonetheless, the financing of public sector employees constitutes the largest proportion of total exposures in retail credit, who have stable employment and income levels, providing further risk mitigation to the sector (Chart 4.1.3).

Chart 4.1.3: Retail Portfolio Based on Employee Type

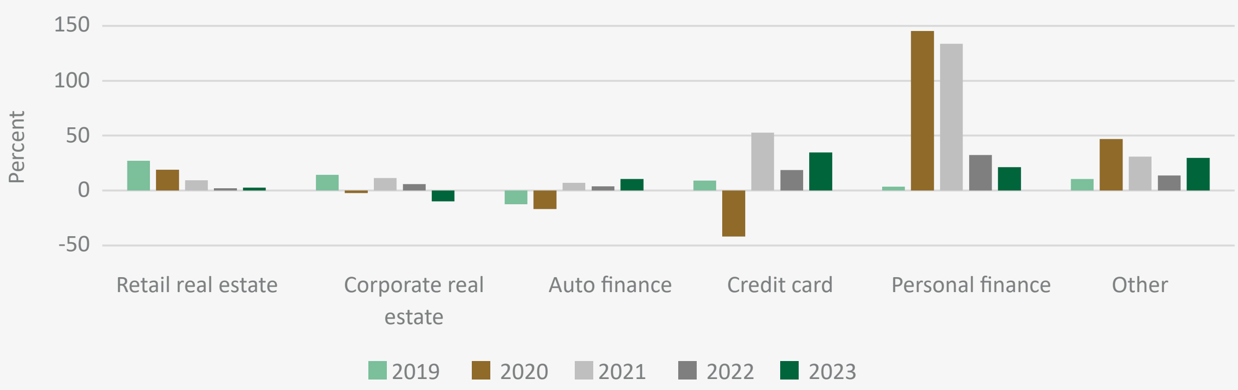


Source: SAMA

Non-real estate lending fueled significant growth in finance companies' total credit for 2023 compared to real estate loans.

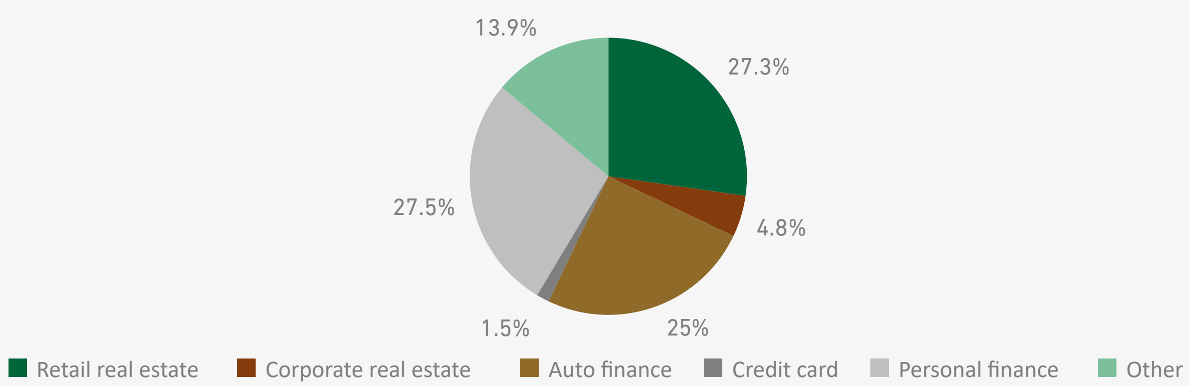
The observed growth in the total credit of finance companies in 2023 is mainly attributable to the growth in non-real estate lending, which constitutes 67.9% of total financing. Personal finance experienced a 21.3% year-over-year growth in 2023, leading to a total weight of 27.5% of total credit. Furthermore, auto finance saw credit growth of 10.4% year-over-year, representing 25% of the total finance companies' portfolio (Chart 4.1.4) and (Chart 4.1.5).

Chart 4.1.4: Credit Growth by Activity



Source: SAMA

Chart 4.1.5: Portfolio Weights by Activity

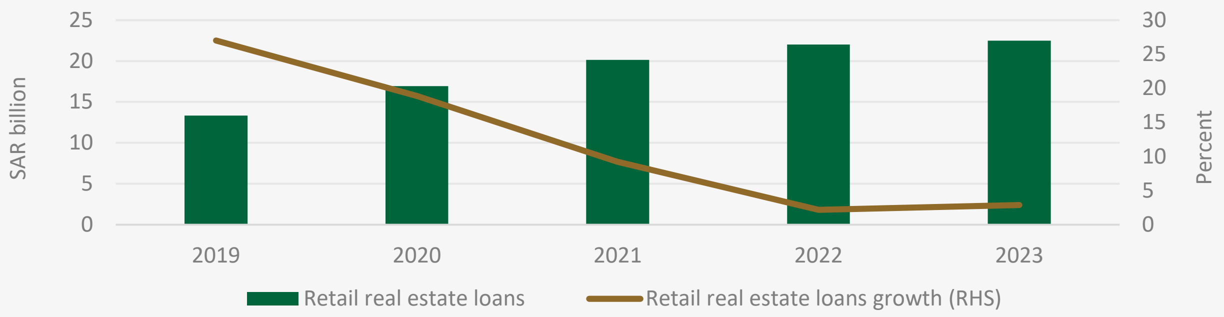


Source: SAMA

Both retail and corporate real estate loans experienced a slowdown.

Growth of retail estate loans decelerated, with an increase of only 2.7% in 2023 (Chart 4.1.6). The slowdown in retail real estate credit growth can be attributed to the fact that initial growth rates came from a low base. On the other hand, growth in corporate real estate loans has fluctuated over the past five years. The amount of these loans has dropped to SAR 4.1 billion in 2023, reflecting a decrease of 9.9% (Chart 4.1.7), which contrasts with the trends exhibited in corporate real estate lending by the banking sector.

Chart 4.1.6: Retail Real Estate Loans



Source: SAMA

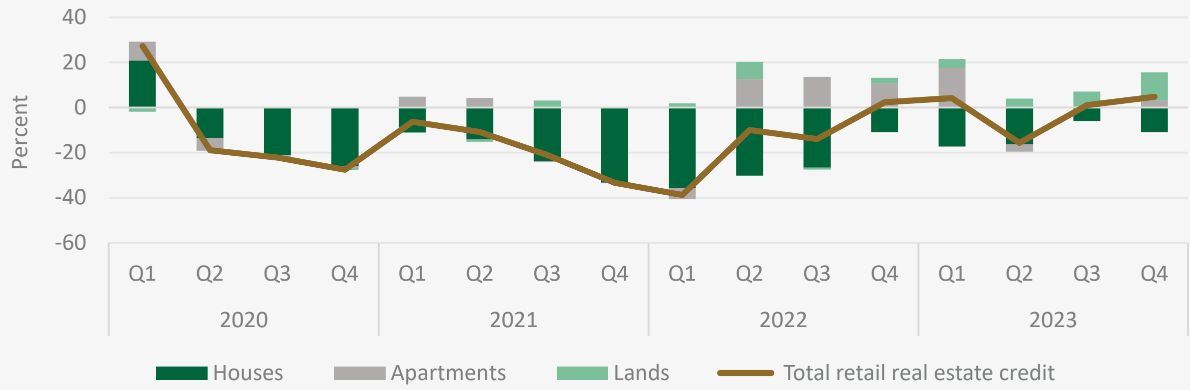
Chart 4.1.7: Corporate Real Estate Loans

Source: SAMA

Financing for residential lands was the main driver behind the growth in retail new-mortgages in 2023.

The total retail new mortgages financing provided by finance companies grew by 4.8% year-over-year, reaching SAR 0.9 billion by the end of Q4 2023. This growth was driven primarily by the increase in financing for residential lands (Chart 4.1.8). To manage this expansion efficiently, collaboration with key stakeholders, such as the Saudi Real Estate Refinancing Company (SRC) has been paramount for finance companies. The SRC's role in providing liquidity can significantly influence the path of mortgage financing for both finance companies and banks.

Chart 4.1.8: Annual Change in Drivers for Retail New-Mortgages Financing

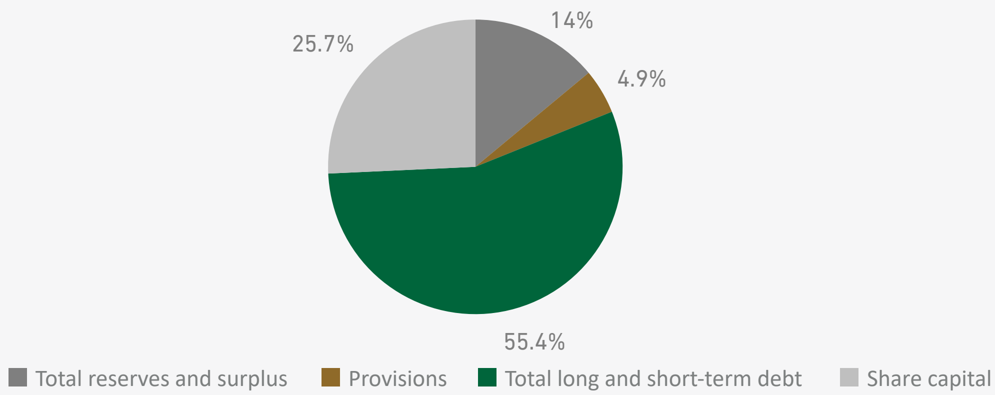


Source: SAMA

Finance companies relied on debt as a primary source of funding, with the leverage ratio increasing, but staying within regulatory limits in 2023.

Total funding sources for finance companies amounted to SAR 60.1 billion at the end of 2023, where borrowing activities were the primary sources of funding. Debt comprised the largest share of funding at 55.4% of total financing, while other sources of financing, such as share capital, total reserves and surplus, and provisions contributed by 25.7%, 14%, and 4.9%, respectively (Chart 4.1.9). Total liabilities rose from SAR 34.7 billion in 2022 to SAR 40.3 billion in 2023, marking a 16.4% jump. This rise reflects substantial growth in total debt, which rose by 21.3% compared to 2022, indicating greater reliance on debt to fund asset growth.

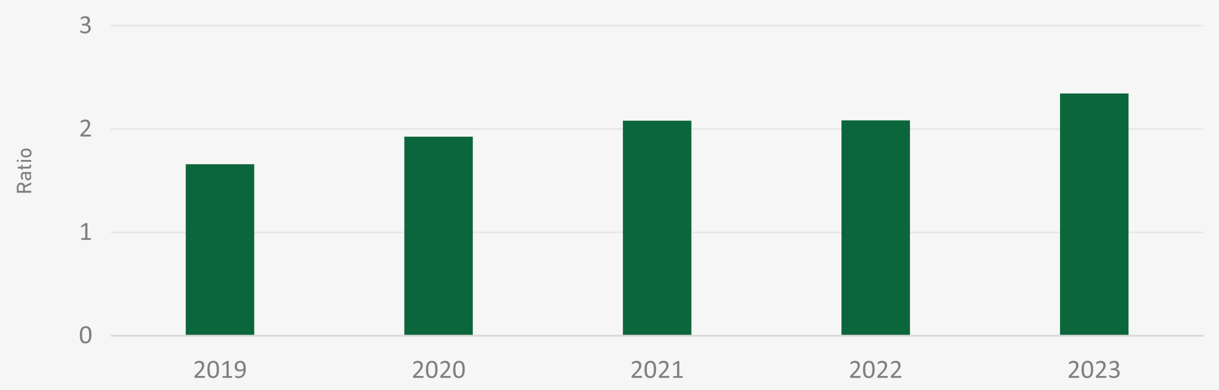
Chart 4.1.9: Source of Funds



Source: SAMA

The leverage ratio is a measure of a company's capital adequacy and the financial risk it bears. Finance companies recorded a leverage ratio of 2.3 times in 2023, suggesting that a significant portion of their capital structure was funded by debt, which indicates a higher level of funding risk compared to previous years. It is important to underscore SAMA's role in regulating leverage risk by imposing caps on balance sheet leverage based on activity and monitoring leverage ratios periodically (Chart 4.1.10).

Chart 4.1.10: Leverage Ratio

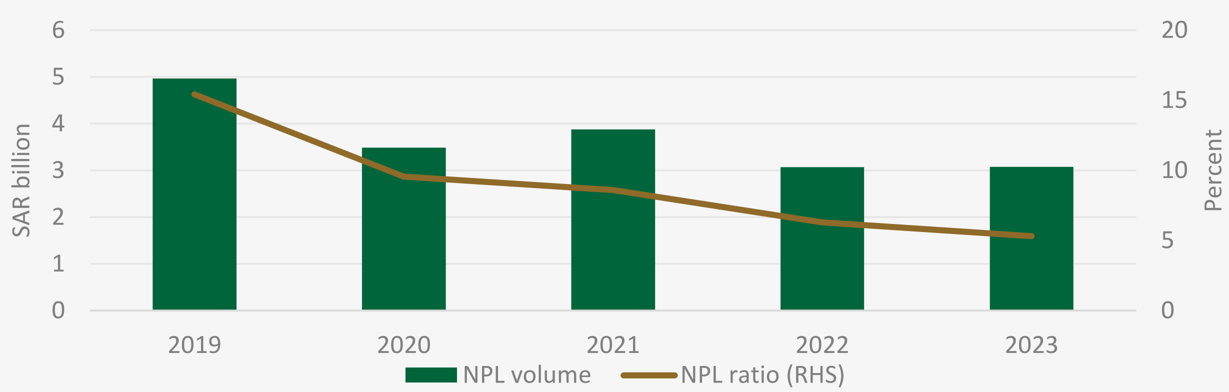


Source: SAMA

The NPL ratio witnessed a modest decline in 2023.

The NPL ratio, which measures the proportion of loans that are delinquent or in default, declined to 5.4% in 2023. The ratio is considered relatively low compared to the pre-Covid-19 pandemic period. Although the NPL ratio for finance companies decreased by nearly 0.9% from 2022 to 2023, it tends to be higher than that for the banking system due to the different underlying credit profiles of the respective target segments. Overall, the NPL ratio remained steady throughout 2023, providing stability to the finance companies sector in the Kingdom (Chart 4.1.11).

Chart 4.1.11: NPLs Volume

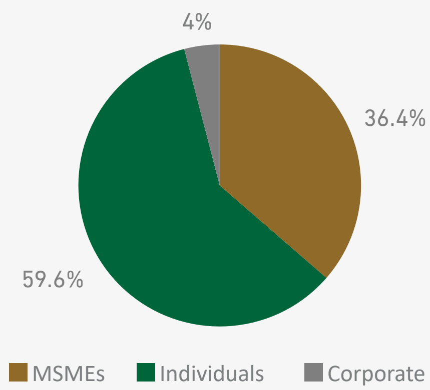


Source: SAMA

The breakdown of impaired loans by finance companies reveals that the individuals sector holds the highest NPL ratio, accounting for 59.6% of total NPLs in 2023, followed by MSMEs and corporate sectors at 36.4% and 4%, respectively (Chart 4.1.12). When examining NPLs by activity, personal finance accounts for the largest portion of the NPL ratio for finance companies, standing at 35.7% of total NPLs in 2023 (Chart 4.1.13).

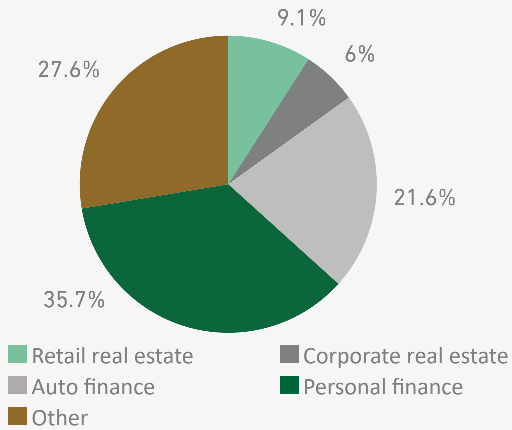
The default rate in the credit portfolios of finance companies has been relatively higher than that in banks' portfolios, mainly due to a greater focus on higher-risk market segments, with MSMEs accounting for a larger portion of exposures than corporate ones.

Chart 4.1.12: NPLs by Sector



Source: SAMA

Chart 4.1.13: NPLs by Activity



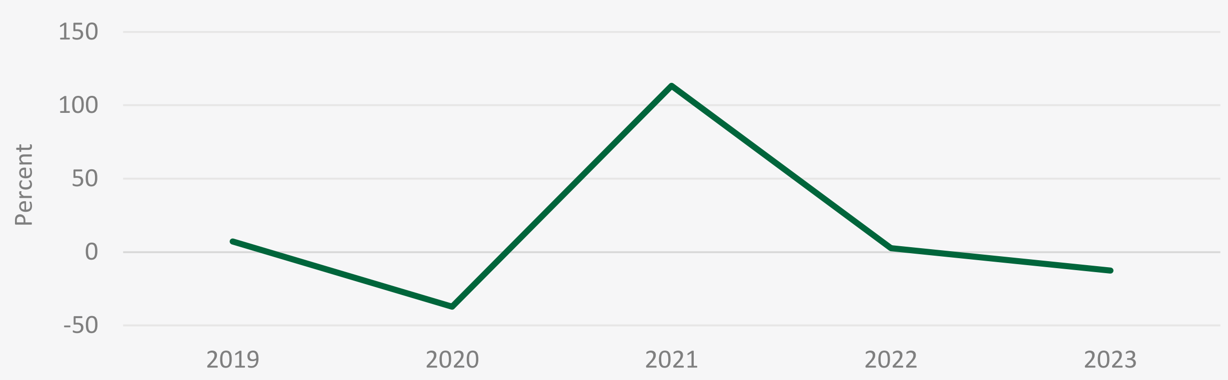
Source: SAMA

Write-offs for finance companies witnessed a decrease of 10.1% in 2023, declining from SAR 1.5 billion in 2022 to SAR 1.3 billion. The decrease in write-offs and decline in NPL ratios can be attributed to the improved credit quality of loan portfolios.

Finance companies displayed resilience despite a modest slowdown in net income post-Covid-19 pandemic recovery.

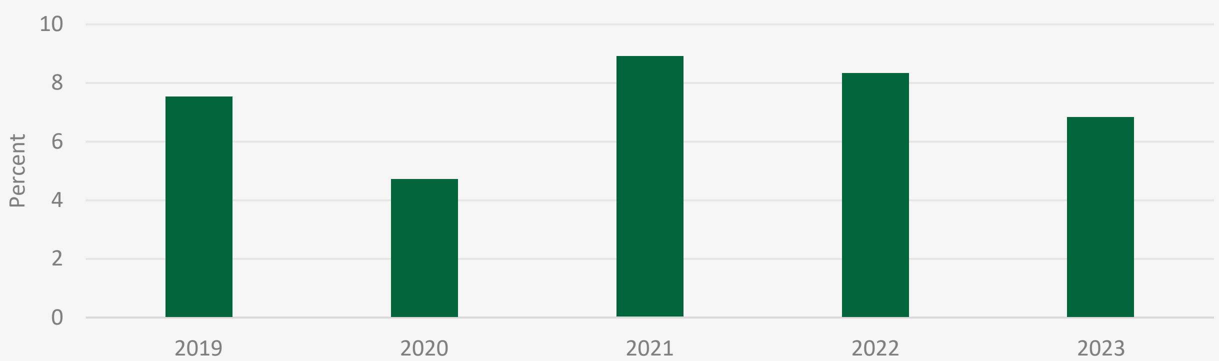
The aggregate net income of finance companies contracted by 10.9%, reaching SAR 1.7 billion by the end of 2023 compared to SAR 1.9 billion in 2022. The decline in profits is partly linked to the high leverage in finance companies. Specifically, given that debt financing represents more than half of finance companies' capital structure, this could negatively affect net income during periods of high interest rates, such as those experienced in 2023. Higher debt levels led to increased interest expenses, reducing net income (Chart 4.1.14), and causing ROE to decline from 8.3% in 2022 to 7% in 2023 (Chart 4.1.15).

Chart 4.1.14: Net Income Growth



Source: SAMA

Chart 4.1.15: ROE



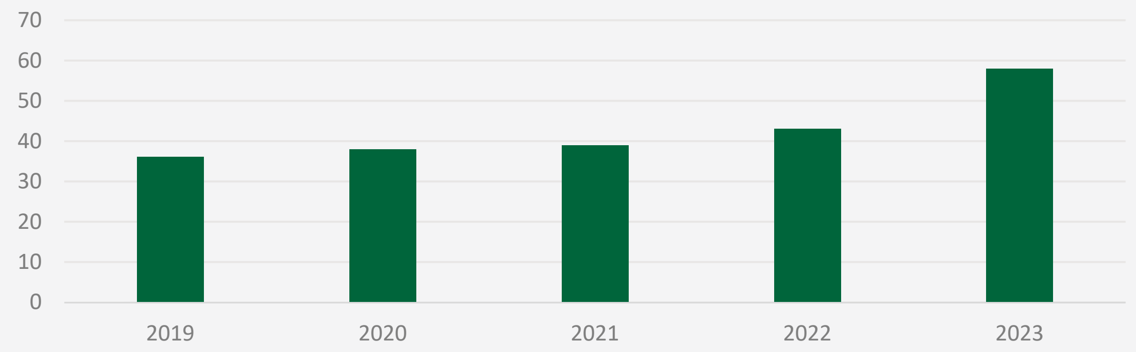
Source: SAMA

Box 4.1.1: Regulatory Developments for the Finance Companies Sector

In January 2023, SAMA amended Article 8 of the Implementing Regulation of the Finance Companies Control law. The aim was to lower the minimum paid-up capital requirement for finance companies intending to engage in finance business for MSMEs. SAMA announced the issuance of the Instructions for Practicing Aggregation Activity as an annex of the Rules of Licensing Finance Support Activities in May 2023. These instructions aim to set minimum standards and procedures required to conduct aggregation activity and ensure the growth and sustainability of the finance sector while protecting consumer rights. Moreover, SAMA issued the Standard Retail Consumer Finance Contract in August 2023 and the Rules Governing Calculation of Annual Percentage Rate (APR) in November 2023. In December of that year, SAMA published Rules for Regulating Buy Now Pay Later (BNPL) Companies. These initiatives reflect SAMA's vital regulatory role and ongoing efforts to advance the finance sector and enable the Fintech sector.

Nonbank financial institutions, including finance companies, have experienced significant expansion, providing a diverse array of financial products beyond traditional bank offerings. As shown in Chart A, the number of licensed finance companies reached 58 by the end of 2023 compared to 43 in 2022, marking a 34.9% increase. This expansion, aligned with a 5.6% increase in total capital in 2023, reaching SAR 15.5 billion, signifies a growing market and heightened demand for the financial services offered by finance companies. As a result, the companies are motivated to expand their capital base.

Chart A: Total Number of Licensed Finance Companies



Source: SAMA

The licenses provided span a spectrum of activities ranging from real estate finance, consumer finance, MSME finance, finance leasing, production asset finance, credit card finance, debt-based crowdfunding, and BNPL. Issuing licenses to finance companies brings benefits to the finance sector in the Kingdom and attarcts a new segment of investors and other players. These initiatives underscore SAMA's unwavering commitment to supporting the finance companies sector, enhancing the efficiency of financial transactions and promoting innovative solutions for financial inclusion in Saudi Arabia.

Box 4.1.2: BNPL Services in Saudi Arabia

BNPL services have increasingly become popular in Saudi Arabia, as they offer a more convenient way to fund transactions. The BNPL payment model allows consumers to make purchases online or in-store and defer payment with zero interest; payments are typically made in installments. The acceleration and expansion of e-commerce after the Covid-19 pandemic made BNPL more attractive. Saudi Arabia has also experienced rapid digital transformation with increasing smartphone penetration. Additionally, the Kingdom's large population of young people, who are tech-savvy and open to new payment methods, has helped increase the demand on BNPL services.

BNPL companies started gaining traction in Saudi Arabia in early 2023, with SAMA licensing seven companies by the end of the year. As the popularity of BNPL services grew, it attracted attention from regulators overseeing consumer protection and responsible lending practices. In December 2023, SAMA issued rules to regulate and set minimum standards for BNPL companies. It is worth noting that the minimum capital for a BNPL company is SAR 5 million, subject to adjustment by SAMA as it deems appropriate. The development of these rules will aid the sector's growth and sustainability as they safeguard users' rights.

Two of the regulators' main concerns regarding BNPL services include consumer protection and the accumulation of default risk. Consequently, SAMA remains cautious and monitors BNPL activities to safeguard consumers. This oversight ensures compliance with regulatory standards and aids in detecting possible issues related to buyer protection. To mitigate a potential increase in credit risk, SAMA has proactively issued its Rules for Regulating BNPL Companies in November 2023.

As part of the activity provisions, BNPL services must comply with the Responsible Lending Principles for Retail Consumers. These rules aim to restrict the onboarding of high-risk customers and the buildup of credit risk beyond a preset threshold. Regulatory leverage limits have been introduced to cap the credit exposure of BNPL providers. Furthermore, all BNPL providers are required to perform credit checks and report customer credit information to the Saudi Credit Bureau (SIMAH). The rules are expected to mitigate potential vulnerabilities, with limited material impact anticipated over the next three to five years.

Box 4.1.3: Development of SRC[11]

Concurrent with solid mortgage credit growth, SRC, with a paid-up capital of SAR 5 billion, has continued to expand operations. SRC has grown its balance sheet through various channels, including through engaging with primary lenders to acquire portfolios of retail real estate finance contracts, and through offering short-term financing credit facilities. The company funds the purchase of these loan portfolios through the issuance of financial instruments to capital markets investors.

To date, SRC has issued SAR-denominated medium and long-term sukuk with maturities ranging from five to ten years, the majority of which benefit from a payment guarantee provided by the Ministry of Finance (MOF). The aim is to improve secondary market liquidity for real estate finance contracts originated by primary lenders as part of a broader objective of achieving a 70% homeownership rate by 2030. Additionally, the company collaborates closely with the Ministry of Municipal and Rural Affairs and Housing (MOMRA), banks, real estate finance companies, and other stakeholders to increase homeownership in the Kingdom. SRC also offers educational tools and resources to assist buyers in making informed decisions throughout the home-buying process.

In 2023, SRC registered a notable 47.7% growth in assets, with total assets reaching SAR 31 billion by year-end, up from SAR 21 billion at the end of 2022, through purchasing portfolios from banks and finance companies.

SRC has executed borrowing transactions by issuing debt securities and establishing credit lines from banks. By year-end 2023, the level of outstanding debt issuances rose to SAR 20.6 billion from SAR 13.8 billion at the end of 2022, representing a 49.8% increase, which broadly aligns with the growth in balance sheet assets. Furthermore, the company's leverage ratio rose from 3.7 times in 2022 to 5.3 times in 2023. This uptick in leverage highlights SRC's heightened reliance on debt financing to support its asset growth.

SRC maintained a relatively stable ROA of 0.47% in 2023, compared to 0.49% in 2022. Meanwhile, the ROE noticeably improved from 2% to 2.7%, as income growth outpaced the rise in operating expenses. SRC's NPL ratio increased in 2023, reaching 0.5%, compared to 0.1% in 2022, but remains very low.

SRC's portfolio is still considered small; however, its growth has significantly accelerated in recent years, necessitating vigilant monitoring by SAMA, particularly regarding its increasing interconnections with the domestic financial system. SAMA has established comprehensive rules and regulations for the real estate market and finance companies that also apply to SRC. These regulations aim to govern the market and enhance risk management. Since most of the company's issued sukuk are guaranteed by the MOF, this support substantially reduces the risk to investors and the overall financial system.

[11] Sources: SAMA, SRC Board of Directors report, and SRC financial statements.

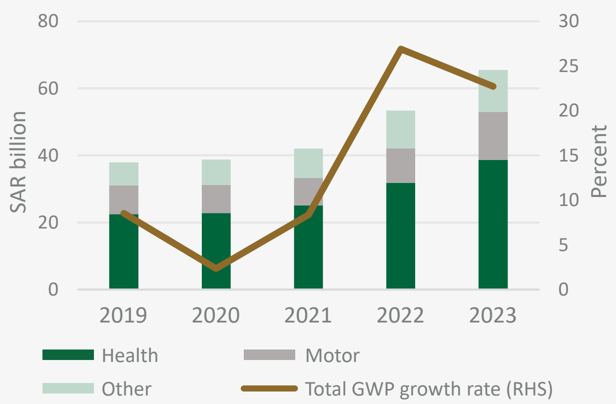
Looking ahead, SRC aims to further diversify and increase its funding sources with near-term plans to issue US-dollar denominated bonds in global markets as a step toward attracting foreign investment. It also plans to securitize portfolios through MBS offerings. These strategies will ensure a steady flow of investment and provide the liquidity needed to support further purchases of mortgage portfolios, ultimately fostering growth in the real estate financing sector in the Kingdom.

4.2 Insurance Sector

The gross written premiums continued to grow in 2023, underpinned by the continued expansion in non-oil sector.

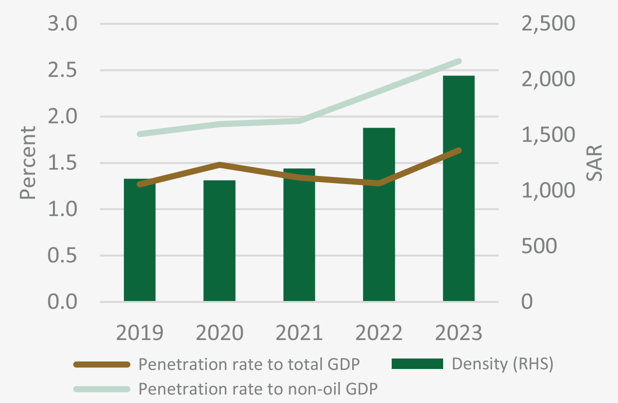
The insurance sector's gross written premiums (GWP) increased in 2023 by 22.7% compared to 2022. Broken down by business line, GWP growth in 2023 is attributed to a 38.2% increase in motor insurance, a 21.4% increase in health insurance, and a 12.5% increase in other insurance.[12] In addition, mandatory private health insurance for expats, an increase in motor sales, enforcement of the requirement for motor insurance, and the rising demand for protection and savings insurance and engineering insurance have all supported the growth of general insurance. This growth is in tandem with the non-oil sector activity. The insurance sector's total assets remained relatively small compared to the overall financial system. However, the sector's contribution to overall GDP increased in 2023, reaching 1.6% compared to 1.3% in 2022 (Chart 4.2.1) and (Chart 4.2.2).

Chart 4.2.1: Segments Contribution to GWP



Source: IA, GASTAT

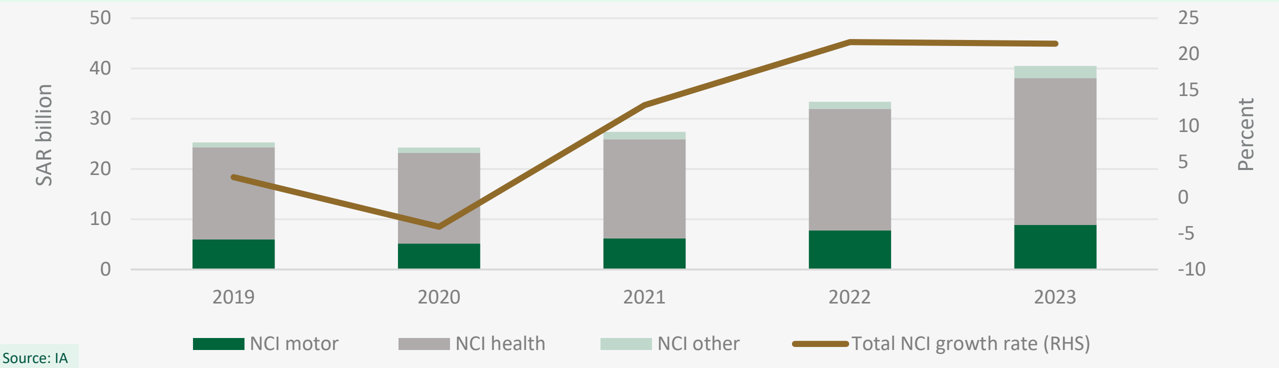
Chart 4.2.2: Insurance Penetration and Density



Source: IA

The insurance sector net claims incurred (NCI) increased by 21.5% in 2023 compared to 2022, reaching SAR 40.5 billion. This increase could be attributed to a mandatory health insurance for expats, a higher number of insured motor and motor sales, and a thriving construction industry, which can be observed with the 20.8% rise in health claims, and 14% rise in motor claims (Chart 4.2.3).

Chart 4.2.3: Segments Contribution to NCI



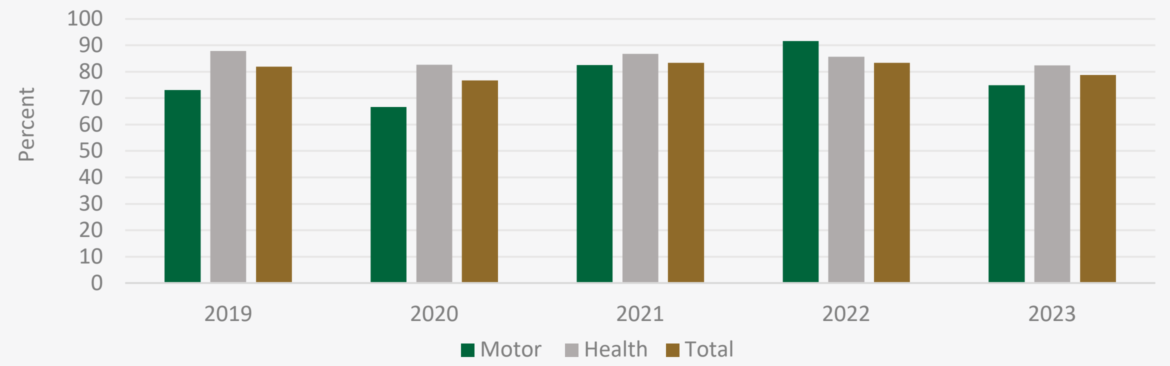
Source: IA

[12] Other insurance: All other business lines of insurance except health and motor insurance. The increase was driven mainly by an increase in protection and savings insurance (36.9%), engineering insurance (32.1%), and property insurance (14.2%).

The sector-wide loss ratio decreased, contributing to the rebound in insurance profitability.

The overall loss ratio[13] decreased by 5.1% from 82.9% in 2022 to 78.7% in 2023. The decline is attributed to an increase in GWP and net earned premiums (NEP) of 22.7% and 25.2%, respectively, in addition to higher growth in the health insurance segment's NEP compared to its NCI in 2023. The improvement stemmed mainly from a lower loss ratio in the motor insurance segment, registering 74.8% in 2023 compared to 91.5% in 2022. The increase in insured motors and enforcement of the third-party coverage requirement improved the collection rate (Chart 4.2.4).

Chart 4.2.4: Loss Ratio

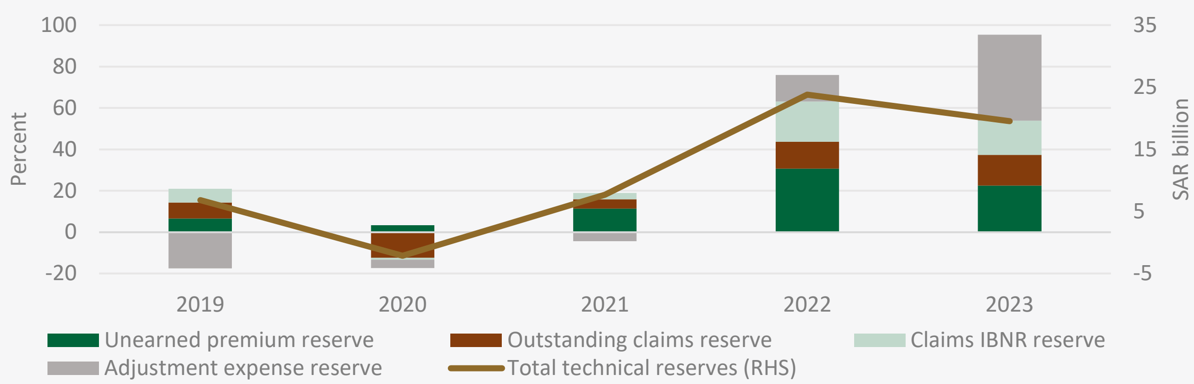


Source: IA

Insurance reserves increased in 2023 driven by a 22.5% increase in unearned premium reserves, enhancing the sector's solvency margins.

Technical reserves increased by 19.5% in 2023 compared to 2022. The weight of the technical reserves components varies, with 57.4% for unearned revenue reserves, 21.4% for outstanding claims reserves, 20.9% claims incurred but not reported (IBNR) reserve, and 0.2% for the adjustment expense reserves. As such, this increase is driven by a 22.5% rise of unearned premium reserves and a 14.9% increase in outstanding claims reserves[14] (Chart 4.2.5).

Chart 4.2.5: Technical Reserves Composition – Growth Rates



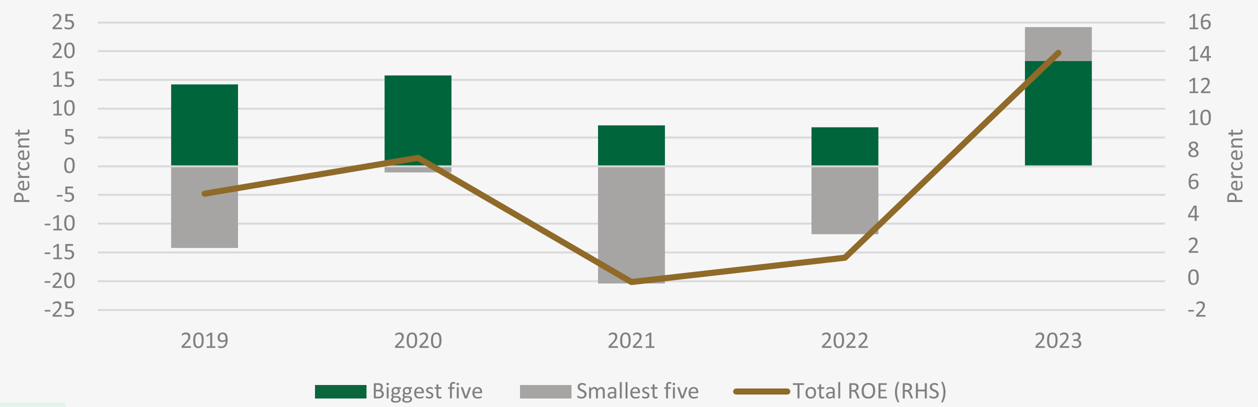
Source: IA

[13] The loss ratio is defined as the percentage of NCI over the NEP.
[14] The adjustment expense reserve is shown in Chart 4.2.5 with a 41.6% increase in 2023; however, it represents 0.2% of total technical reserves.

The sector's profitability improved, driven by the rise in net investment income.

The overall profitability of the insurance sector increased. Net income registered SAR 3.2 billion in 2023 compared to SAR 244.3 million in 2022. In addition, ROE increased to 14.1% in 2023 (Chart 4.2.6). This could be attributed to the positive financial performance of large insurance companies during 2023, driven by the availability of new insurance products, increases in net written premiums in health insurance and motor insurance of 20.9% and 42.5%, respectively, and the positive impact of a higher interest rate environment on investment returns. The smallest five companies also recorded positive ROE ratios, for the first time since 2018.

Chart 4.2.6: ROE

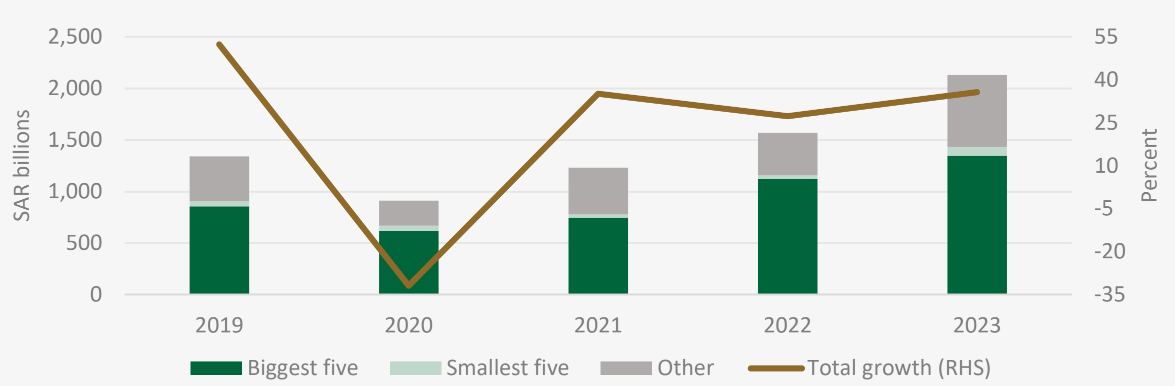


Source: IA

Investment income recorded an increase of 35.7% in 2023 compared to 2022 to reach SAR 2.1 billion.

Investment portfolios of insurance companies tend to be concentrated in deposits, which benefited from the recent rise in interest rates. The Insurance Authority (IA) mitigates investment concentration risk through policy measures such as imposing a 50% minimum threshold of total assets to be invested in local currency and limiting investments outside the Kingdom to 20% of total investments. The implementing regulations of the law also set thresholds and limits on investment instruments to mitigate concentration risks (Chart 4.2.7).[15]

Chart 4.2.7: Investment Income



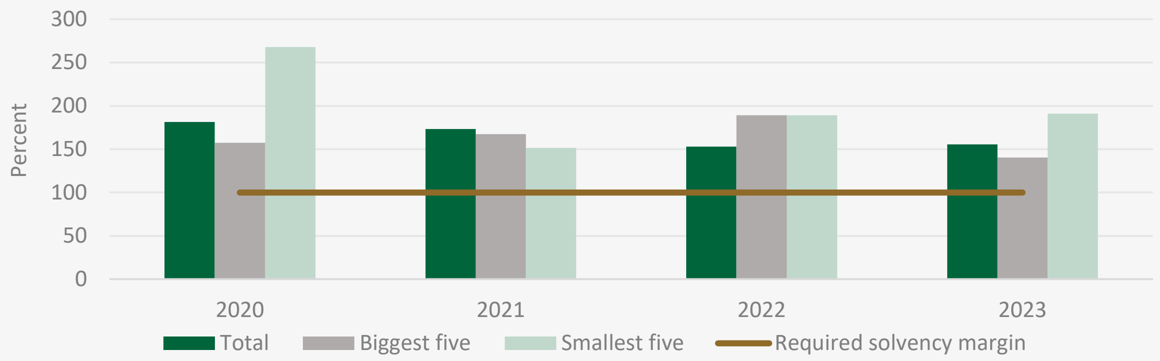
Source: IA

[15] Table 1 of the Implementing Regulations of the Cooperative Insurance Companies Control Law provides further details.

The solvency margin of the insurance market remained well above the 100% regulatory requirement and provided ample buffer against potential adverse developments.

The insurance market's solvency margin increased from 152.8% in 2022 to 155.6% in 2023, well above the 100% regulatory requirement. The solvency margin provided ample buffer against potential adverse developments such as large claim payouts, regulatory changes, and economic downturns. Small insurance companies had a stronger position than large companies in terms of solvency, reaching 190.8% by the end of 2023 (Chart 4.2.8).

Chart 4.2.8: Solvency Margin

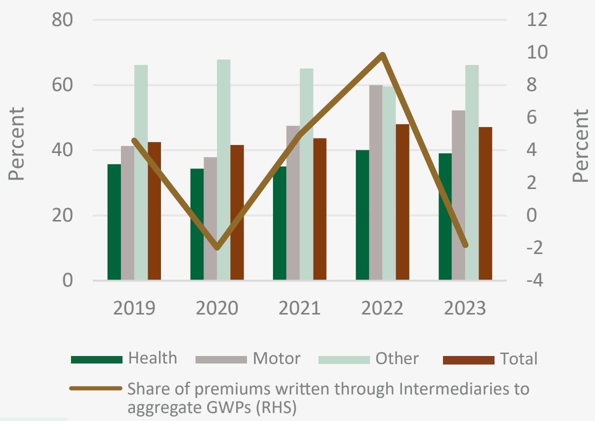


Source: IA

Although premiums written through intermediaries increased, their share of aggregate GWPs has slightly declined.

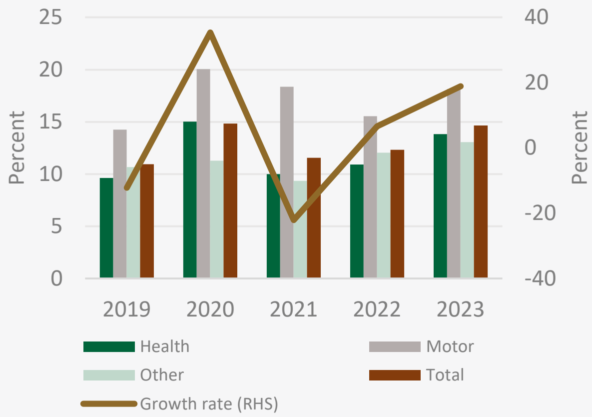
Overall, total premiums written through intermediaries increased by 20.5% in 2023 compared to 2022; however, their share of aggregate GWPs decreased. Intermediaries' commission margins were driven mainly by health insurance, which accounted for 46.1% of the total commission received by intermediaries, followed by motor insurance at 29.9% and other insurance at 24%. The commission received by intermediaries grew by 43.3% in 2023 compared to 2022 (Chart 4.2.9) and (Chart 4.2.10).

Chart 4.2.9: Share of Premium Written through Intermediaries to Total GWPs



Source: IA

Chart 4.2.10: Intermediaries Commission Received as a Percentage of Premiums Written



Source: IA

Box 4.2.1: Regulatory Developments for the Insurance Sector

In August 2023, the Saudi Cabinet approved the establishment of the IA, reflecting an important step in establishing an independent entity that supervises the sector to carry on the efforts in building a strong, vital, and stable insurance sector in the Kingdom. On November 23, 2023, the IA became the authorized regulator of the insurance sector with a dual mandate of regulating and promoting growth of the insurance sector in a manner that enhances its efficiency and stability.

The recent decision to enforce mandatory motor insurance contributed to the improved recovery rate and supported profitability. The focus on privatization and mandatory medical insurance in the private sector is expected to provide structural support to the medical insurance industry. At the same time, tourism and population growth due to Vision 2030 initiatives could support GWP growth, through greater demand for insurance products. The Vision aspires to increase GWP as a percentage of non-oil sector GDP to 4.3% by 2023. The baseline was 1.9% in 2019, and it reached 2.6% by end of 2023.

In February 2023, SAMA announced the licensing of the first foreign health insurance company branch in KSA. The aim was to encourage foreign direct investment to increase competitiveness in the sector and maximize the potential of the Saudi economy, while encouraging innovation in financial services. Furthermore, during 2023, the insurance sector witnessed the merger of two insurance companies (the sixth merger in the insurance sector). The merger aims to improve the level of protection provided to policy holders and increased benefits from economies of scale.

Implementation of International Financial Reporting Standards 17 and 9 took effect as of January 2023, in line with the implementation date set by the International Accounting Standards Board. The new standards are expected to help introduce new elements in the insurance industry, improving human and technological resources, enhancing the transparency of reporting, and enabling the Saudi insurance sector to meet the objectives of Saudi Arabia's Vision 2030.

4.3 Capital Market Institutions

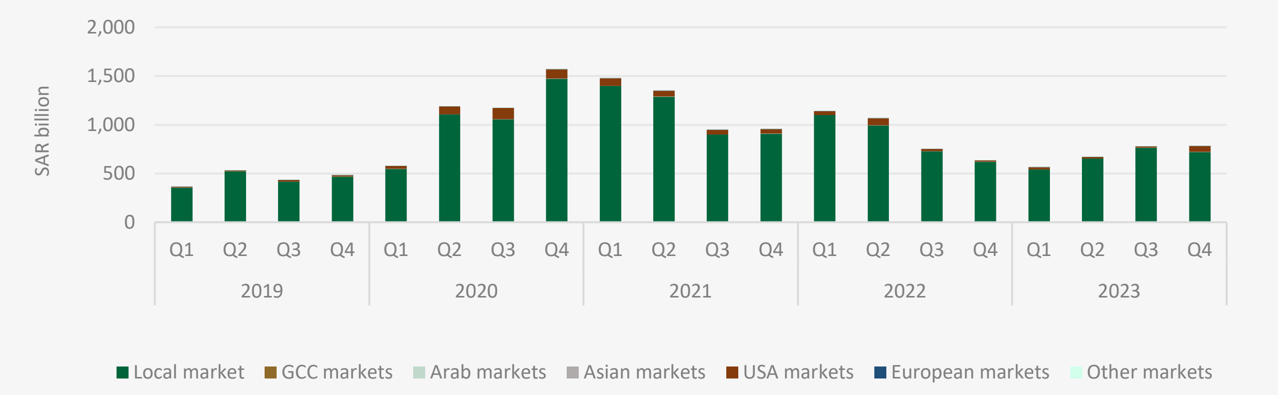
The Saudi capital market performance rebounded in 2023.

The Saudi capital market recovered in 2023 with a growth rate of 14.2% compared to a decline of 7.1% in 2022. The positive performance is attributed to the growth in non-oil activities and expectations around the interest rate path. The price to earning (P/E) ratio increased over the period, reaching 17.6 multiple in December 2023 compared to 12.4 multiple December 2022. The market rebound was reflected in the overall performance of capital market institutions (CMIs) in 2023.

CMIs trading activity continued to be concentrated in the local market.

The total trading value improved following its decline in 2022. It registered a 23.1% increase in 2023, driven by 16.5% growth in local trading activity in the year (Chart 4.3.1). While trading was mostly concentrated in the local market, the value contribution decreased from 97.5% to 92.3%, due to the US market share increasing from 2.3% to 7.5%.

Chart 4.3.1: CMIs Trading Values

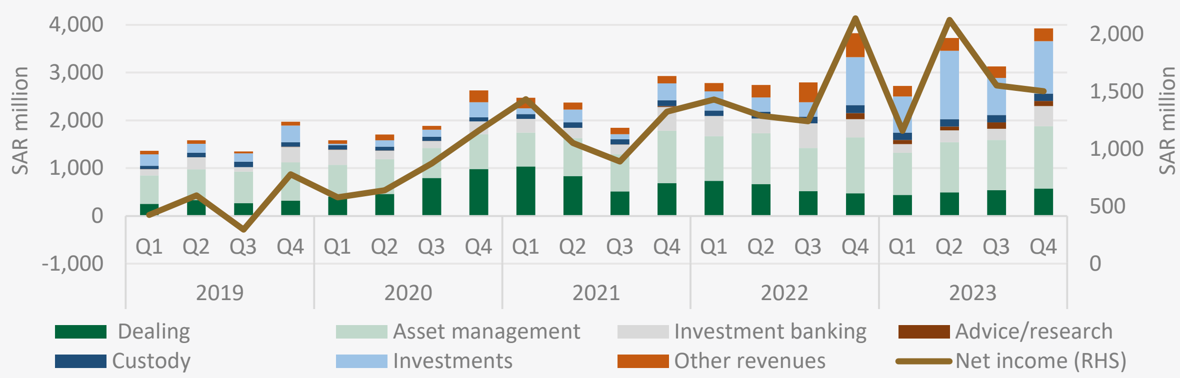


Source: CMA

Despite higher operating expenses, CMI's net income continued to grow.

CMI's revenue grew by 11.2% in 2023, driven by higher revenue from investments; however, it was below the five-year historical average (Chart 4.3.2). On the other hand, operating expenses grew at a pace greater than the five-year historical average, reaching 20.4% by the end of 2023, driven mainly by employee-related expenses. Despite this increase, net income increased by 3.9% to reach SAR 6.3 billion in 2023. Net income remained solid due to investment activities and dealing, where CMIs recorded a ROA of 10.6% in 2023, which was close to its five-year average.

Chart 4.3.2: Revenue Composition

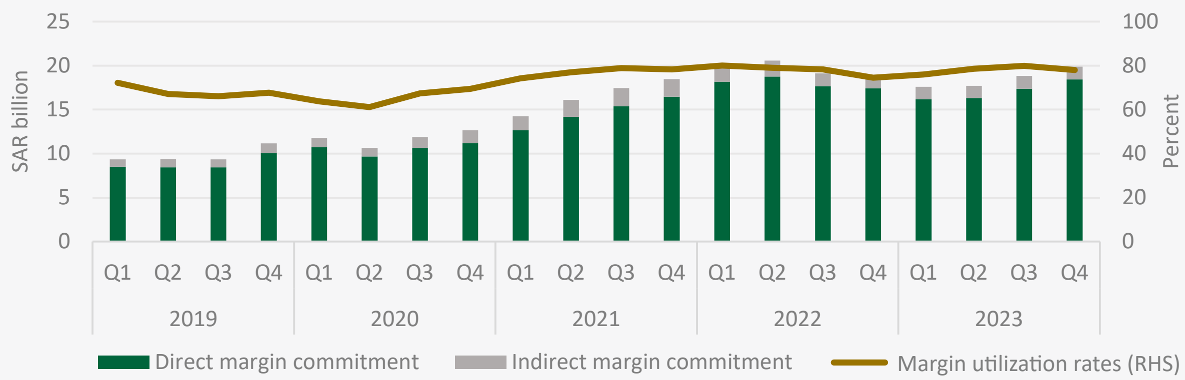


Source: CMA

Margin lending increased while margin utilization rates remained close to 2022 level.

Margin lending is an important product for CMIs, whereby leverage is extended on a collateralized basis to clients seeking to enhance returns. Margin lending rebounded due to an increase in indirect lending, associated with a 5.1% increase in the number of clients by end of 2023, while margin utilization rates have stayed at around the maximum since early 2022 (Chart 4.3.3).

Chart 4.3.3: Margin Lending Commitment

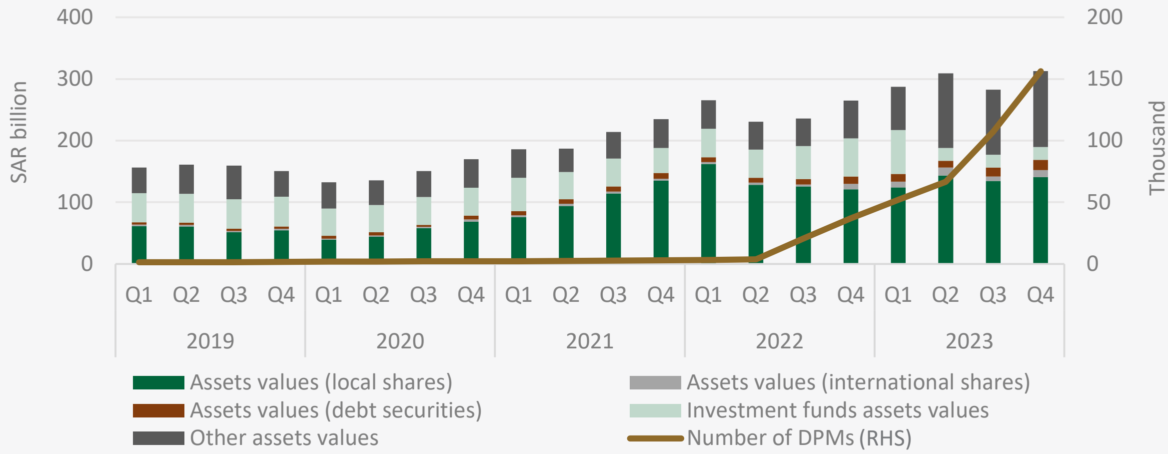


Source: CMA

Fintech firms contributed to increasing the number of discretionary portfolios through retail investor offerings.

The number of DPMs witnessed a significant increase of 322.2% to reach 156,286 portfolios in 2023. However, a closer look reveals that the significant increase in DPMs did not affect total asset values. This was due to the increase in the number of Fintech companies that offered DPMs to retail investors, resulting in a large number of small-sized portfolios as opposed to traditional DPMs, which target high-net-worth investors (Chart 4.3.4).

Chart 4.3.4: DPMs

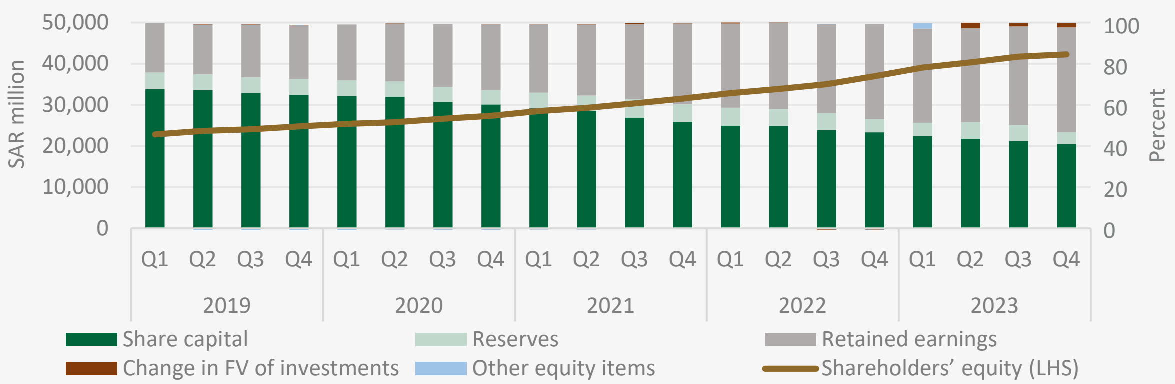


Source: CMA

CMI's profitability increasingly improved the sector's capitalization.

In 2023, CMIs' balance sheet showed a 7.3% increase in total assets. The growth in total assets was driven by an expansion in shareholders' equity of 14.4%, reflecting higher levels of capitalization. CMIs were able to increase their capital through the increase in retained earnings, which rose by 24%, driven by the increase in profitability (Chart 4.3.5). Additionally, CAR calculation was modified to align with the Basel framework (Box 4.3.1). In 2023, CMIs' CAR increased slightly, reaching 27.7% compared to 26.8% in 2022 — well above the minimum requirement of 8% (Chart 4.3.6).

Chart 4.3.5: Shareholders' Equity



Source: CMA

Chart 4.3.6: CAR

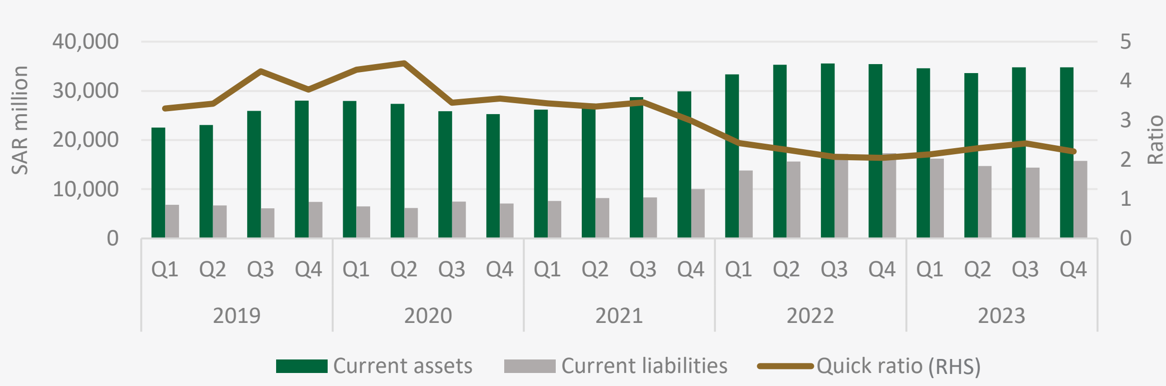
Source: CMA

Note: Historical data was adjusted to reflect the updated calculation methodology.

The CMI liquidity position slightly improved during 2023, reflecting ample coverage to meet short-term liquidity needs.

The quick ratio increased by 8% over 2023, mainly driven by a decrease in current liabilities as CMIs reduced reliance on short-term liabilities in the high interest rate environment experienced since 2022 (Chart 4.3.7).

Chart 4.3.7: Quick Ratio



Source: CMA

Box 4.3.1: CMI's Capital Adequacy Framework

CAR is one of the most important financial metrics for CMIs. It is a measure of an institution's financial strength and ability to absorb losses. Sufficient capital is essential to protect customers and counterparties against a wide range of risks, including but not limited to, credit, market, counterparty, operational, and liquidity risks. A well-designed capital adequacy framework also serves as a warning system, encouraging institutions to refocus their efforts on risk management, as a decrease in an intermediary's capital base can expose them to significantly higher levels of risk.

In order to enhance the stability of CMIs to further boost the confidence of capital market participants and create an attractive investment environment to support national economic growth, the Capital Market Authority (CMA) board approved the amended Prudential Rules in 2023. This resulted from the CMA's desire to enhance the control procedures and prudential level of entities subject to CMA supervision.

To align with the Basel method used for banks, CMA updated the methodology used to calculate the minimum limit of capital adequacy in 2022. The values calculated in RWAs are now obtained by multiplying the exposure by the risk weight, in the case of credit risk, or multiplying the exposure by the risk ratio and then multiplying it by a multiplication factor of 12.5 in the case of market risk or operational risk. This calculation method is similar to that adopted by banks and in the Basel standards, where the minimum coverage ratio is set at 8%.

5

Financial Market Infrastructure, Payment Companies and Cyber Security

5.1 Financial Markets Infrastructure

SAMA plays a critical role in modernizing the secure national payment infrastructure, aligning with national developments and best international practices to raise efficiency and ensure effective risk management.

The Saudi Arabian Riyal Interbank Express is a real-time gross settlement system (RTGS). In addition, sarie instant payments system (IPS) is owned by SAMA. The sarie IPS in 2023 accounted for 4% of all digital payments by volume, as it supports fund transfers across the financial system.

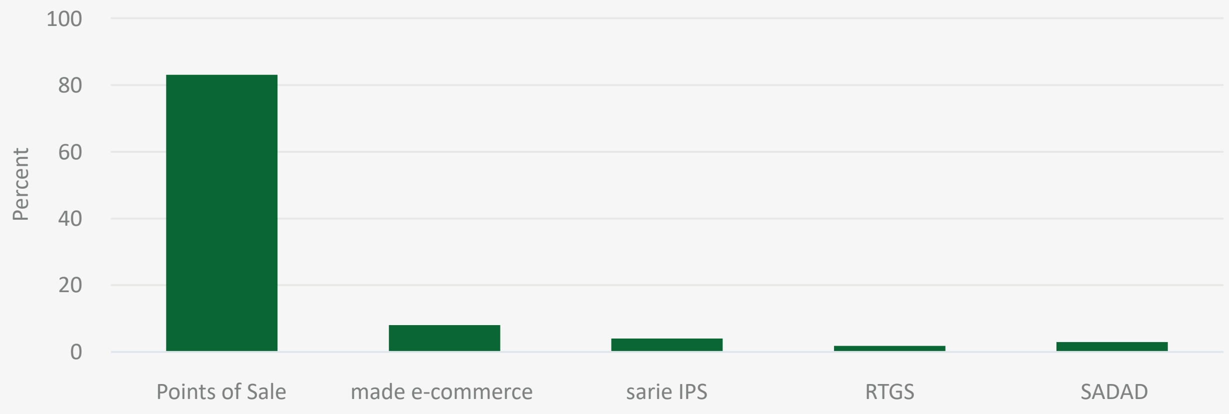
The significant growth in Saudi Arabia's digital infrastructure is in line with the FSDP targets under Vision 2030, and sufficient measures are taken to contain system vulnerabilities.

The payments suite in the Kingdom continued to grow in 2023, with over 10.8 billion in electronic transactions processed through national payments systems used by consumers, businesses, and government sectors. Of all digital payments, 91% were initiated through card-related payment vehicles, with 83% of these conducted in person at a physical point of sale and 8% online through e-commerce using mada cards (Chart 5.1.1). The national payments system mada is owned by SAMA, and connects all points of sale (POS), e-commerce, and ATMs in the Kingdom. The scheme provides interoperable POS payment access for all debit cards issued by eligible system participants through all merchants at physical POS terminals and through eligible payment-gateway operators of e-commerce.

Furthermore, the electronic bill presentment and payment system (SADAD), launched in 2004 as the national Electronic Bill Presentment and Payment (EBPP) system, facilitates payment of government and non-government bills. It is owned by SAMA. Accounting for 3% of all digital payments in 2023, the SADAD payment system served more than 260 of the largest billers in the Kingdom. Since it is integrated with all banks and digital wallets in Saudi Arabia to provide a single channel for bill payments, it plays an important role in developing secured electronic transition protocols between billers and their customers. Billers need only to connect directly with SADAD, rather than with multiple banks, to process bill payments. This simplifies the process for billers and their customers as well as eliminates the need for them to track payments across multiple channels.

These systems are in line with the Kingdom's FSDP, which envisions a less-cash society via a developed digital infrastructure and aims to provide both modified customer experience and operational efficiency. However, operational risks may arise, possibly amplifying potential reputational and contagion risks. Therefore, efforts are strengthened towards sound operational risk management, with periodic reviews of the risk factors to which financial institutions are exposed to.

Chart 5.1.1: 2023 Digital Payments Share – Volume

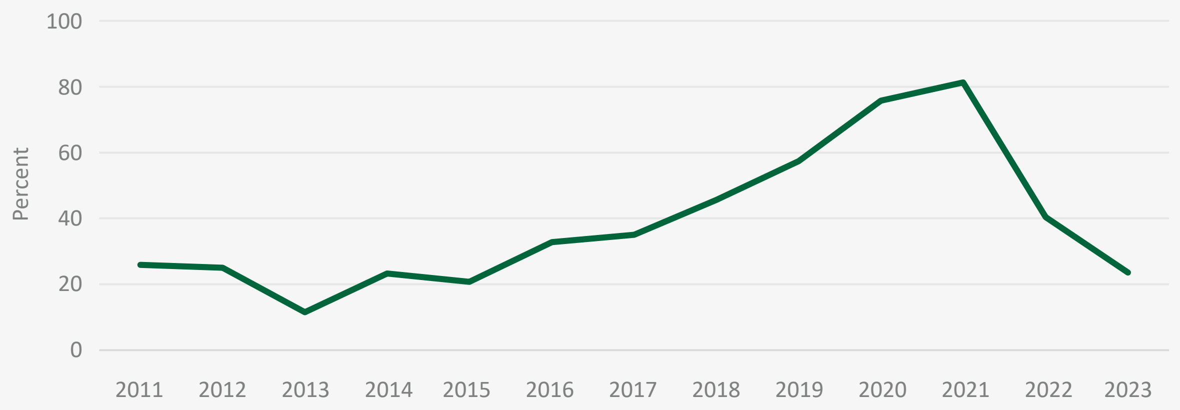


Source: SAMA

The rapid growth in digital payments over the last decade in Saudi Arabia has resulted in a lower share of cash payments. The increasing adoption of a wide range of payments has reduced financial exclusion risks.

The share of non-cash from overall retail payments has increased from 10% of share payment volume in 2010 to 70% in 2023. The digital and non-cash payments expected to account for over 80% of consumer payments by 2030, while the decline in cash share of payments is expected to continue. Meanwhile, card payments in 2023 generated 9 billion transactions on the 1.7 million POS terminals in the Kingdom. It is worth noting that the growth rate of POS transactions volume spiked in 2021 after Covid-19, recording an 81% growth rate compared to 24% volume growth in 2023 (Chart 5.1.2). In value terms, card transactions at POS terminals accounted for SAR 613.9 billion.

Chart 5.1.2: Annual POS Transactions Volume Growth

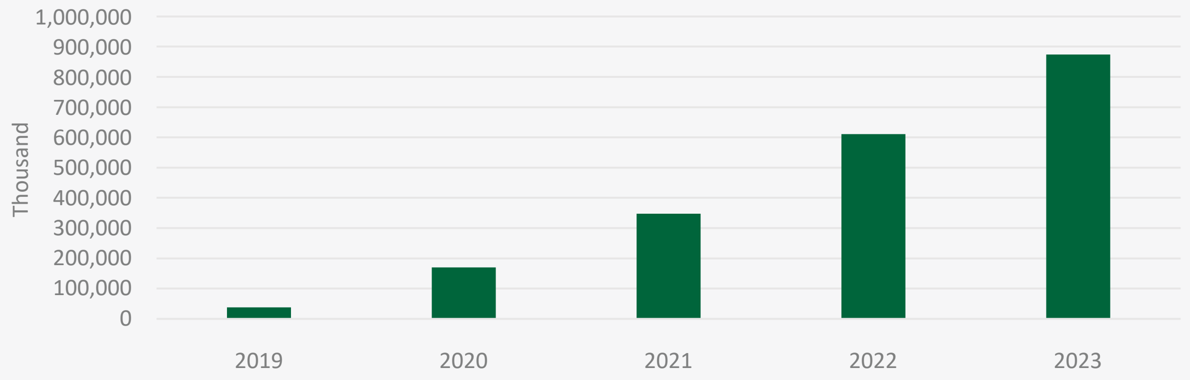


Source: SAMA

The average transaction value (ATV) on card payments at POS terminals in 2023 was SAR 68, down from SAR 77 in 2022 and SAR 225 in 2018, implying a wide adoption level by people and businesses. Of these POS payments, 96% were made using a Near Field Communication (NFC) or contactless interface, which reduces transaction time to less than two seconds and increases both the convenience and popularity of card payments at POS terminals. On closer examination, 53% of these contactless transactions were made using an NFC-enabled card, with 47% initiated using a mobile phone–based interface — no physical card at all. By the end of December 2023, 47.8 million cards had been issued in the Kingdom through eligible card providers.

Meanwhile, the card based e-commerce transaction volume continued to grow through 2023, mada e-commerce transaction portfolio reached 873.7 million — an increase of 43% over 2022 (Chart 5.1.3). In nominal terms, these transactions grew to almost SAR 157 billion, increasing by 28%. Additionally, mada e-commerce reached ATV of SAR 180 in 2023 compared to SAR 201 the previous year. Card-payment activity at POS terminals is expected to remain a substantial contributor to the less-cash economy in the Kingdom.

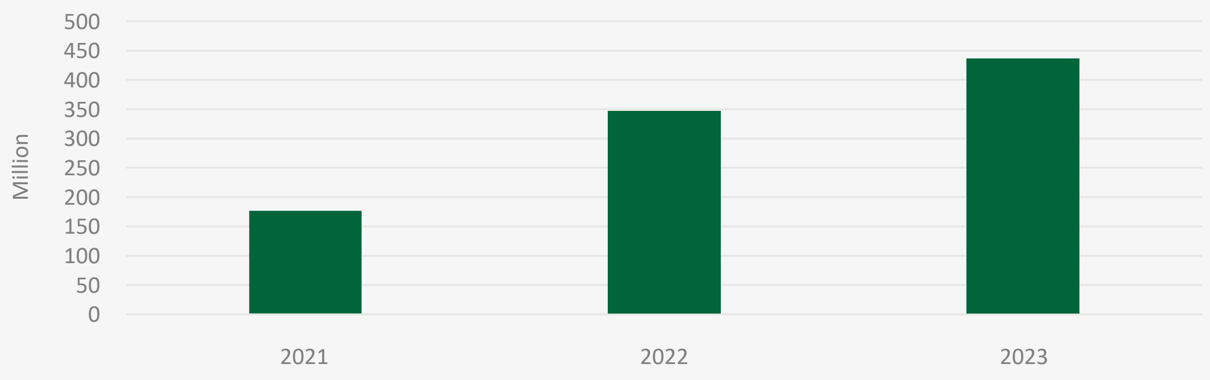
Chart 5.1.3: mada E-commerce Card Transactions Volume



Source: SAMA

Now in its third year of market operation, sarie IPS transaction volume grew by 26% in 2023 to almost 437 million transactions (Chart 5.1.4). sarie still operates primarily in the peer-to-peer market space and typically reflects an ATV of SAR 1,414 a slight reduction (1%) from the equivalent figure in 2022.

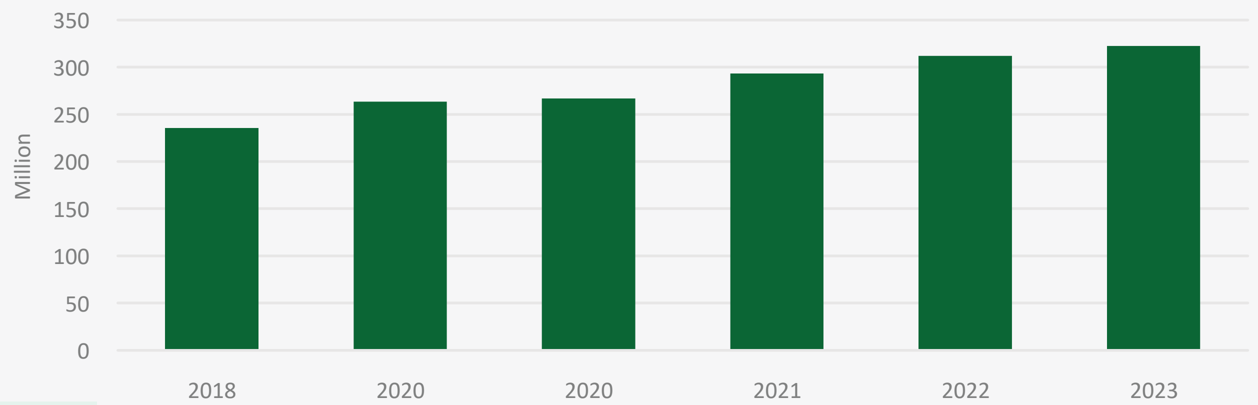
Chart 5.1.4: sarie IPS Transaction Volume Growth



Source: SAMA

On the other hand, bills paid through SADAD continued their steady growth through 2023 with 322.4 million payments, up 3.3% from 2022 across the estimated 8.2 million households in the Kingdom (Chart 5.1.5). A total of SAR 719 billion was paid through SADAD over the year.

Chart 5.1.5: Bills Paid through SADAD



Source: SAMA

Telecommunication and utility bills continued to dominate the biller base for SADAD. They accounted for 60% of all bills paid through the system, with the government sector accounting for almost 28% of the portfolio. A further 10% was sourced from insurance and finance companies. Collectively, these three clusters accounted for 98% of all SADAD-issued bills.

Use of personal or commercial interbank check continued its downward trend in 2023.

It is notable that 951,000 checks cleared in the year — down 22% from 2022. However, checks remained essential as a payment method, with an ATV of SAR 132.6 thousand a 7% increase in ATV over 2022. This suggests that digital payment means continue to draw lower value transactions away from cash and checks, while relatively large amounts were in checks.

Several payment services were developed, extending from the GCC member countries ensuring the ease of cross-border payments while safeguarding the financial system.

In Saudi Arabia, mada is already successfully operating through the GCC Net platform. The system, developed under the umbrella of the Secretariat General of the Gulf Cooperation Council, provides direct ATM withdrawal and POS payment capability for local payment-card holders. As Saudi Arabia is the third-largest country of outward remittances, SAMA will continue to play a role in advancing the 2020 G20 Roadmap for Enhancing Cross Border Payments to make cross-border payments faster, cheaper, more accessible, and more transparent.

These financial market infrastructure payment developments are taken forward with careful considerations in risk management.

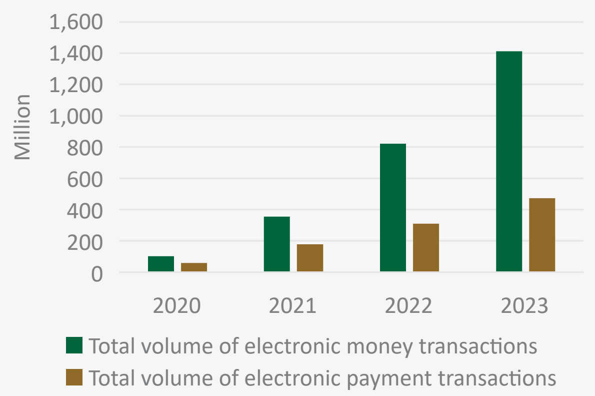
It is notable that a wide range of payment methods has reduced the likelihood of financial exclusion risks. Meanwhile, risk management is continuously monitored mainly in terms of liquidity, third-party dependence, fraud, and compliance. Regarding third-party dependence risk, as financial institutions intersect with other payment-system risks, concerns may arise about potential contagion, compliance, and operational risks. SAMA, through its supervisory role, ensures that these risks are addressed through periodic supervisory reviews and frequent monitoring.

5.2 Payment Companies

The number of payment companies has been increasing in line with financial infrastructure development, which reflects well for the payment sector.

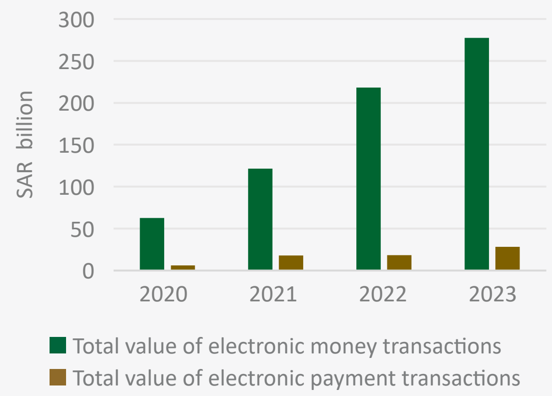
SAMA seeks to maintain and enhance the financial services and products in the Kingdom and ease the facilitation of digital transactions. These efforts have contributed to the notable growth in the number of payment companies licensed by SAMA, reaching 25 by the end of 2023, where the volume of electronic money and payment transactions for electronic money institutions (EMIs) and payment institutions (PIs) increased by 72% and 52%, respectively, in 2023 compared to 2022 (Chart 5.2.1). Additionally, the total value of electronic money and payment transactions grew by 27% and 54%, respectively, in the same period (Chart 5.2.2).

Chart 5.2.1: Number of Payment Transactions



Source: SAMA

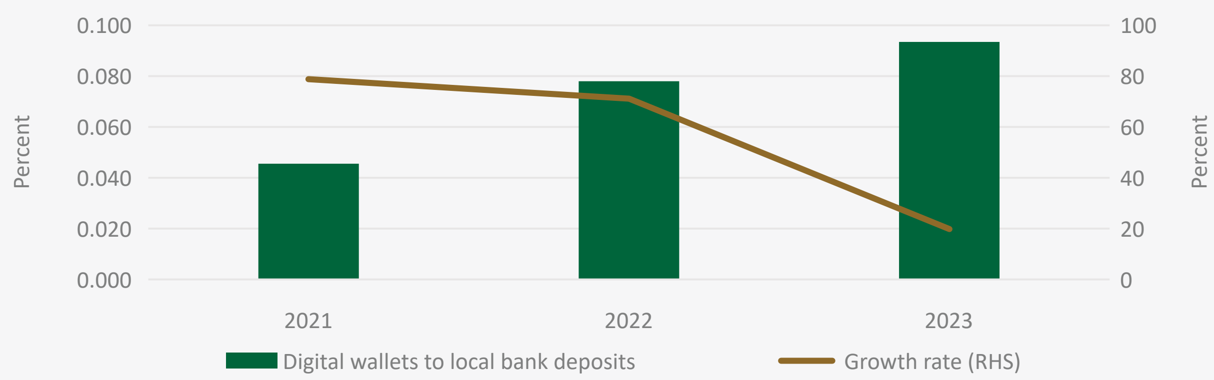
Chart 5.2.2: Value of Payment Transactions



Source: SAMA

With the acceleration of EMIs offering digital wallet payment solutions, their penetration of the broader financial ecosystem has remained modest. Even though the value of the proportion of digital wallet holdings relative to local bank deposits is minor, it experienced an 18% increase by the end of 2023 compared to 2022 (Chart 5.2.3).

Chart 5.2.3: Digital Wallets to Local Bank Deposits



Source: SAMA

Payment companies could face interconnectedness risks as they continue to experience growth.

Despite the significant growth in numbers, payment companies face interconnectedness risks, as part of their business model is dependent upon banks, which serve as vital infrastructure providers and wield substantial influence over the payment companies' operations. Moreover, increasing interconnectedness may introduce vulnerabilities and dependencies that pose systemic risks. Any risk leading to failures or damage within banks' systems, such as operational risk, could cascade through the payment ecosystem, hindering transaction processing and liquidity management for payment companies. Such issues could have far-reaching implications for the stability of the financial system.

SAMA constantly updates payment regulations to mitigate risks and safeguard the financial system's integrity.

In response to the potential risks that could arise in the payment sector and to ensure a stable and secure expansion of financial services by payment companies, SAMA's regulatory framework was notably strengthened to bolster the financial system's resilience and ensure the implementation of strategies and frameworks for the surveillance and governance of risks. The Law of Payments and Payment Services, introduced in October 2021, and the Implementing Regulations, unveiled in June 2023, represent SAMA's strategic effort to bolster the integrity, efficiency, and risk frameworks of payments systems and services across the Kingdom. These regulatory measures were designed to achieve several critical objectives: enhance the robustness of payment infrastructures, fortify user protection, foster an environment conducive to innovation and competition in the payment system operations and services, and guarantee the implementation of requisite systems for the management and mitigation of risks associated with the payment sector and the additional risks associated with other interconnected sectors.

5.3 Cybersecurity

Stringent cybersecurity measures by SAMA are crucial in addressing cyber threats that may arise from the digitization of the financial sector.

A successful cyberattack on financial entities could lead to unauthorized access to customer information, which might expose data and allow fraudulent transactions. This would result in financial losses for both financial entities and customers, hampering the overall confidence in the financial system.

Strong cybersecurity measures are crucial for safeguarding consumer and financial entities, and maintaining trust in the financial ecosystem. Cyber threats could have significant effects on financial institutions, impacting various stakeholders including customers, financial entities, and third parties. This could pose systemic risks to the integrity, stability, and resilience of the financial systems and trigger various types of cyber threats, including but not limited to data breaches, financial services disruption, and cyber-enabled fraud.

The financial sector is being transformed by the advent of emerging technologies that make innovative digital services available to customers. At the same time, the cyber-threat landscape is constantly evolving, with attackers using increasingly sophisticated techniques to exploit vulnerabilities. Strong cybersecurity measures help protect against, detect, and respond to a range of cyber threats.

With the constant evolution in cyber risks, SAMA has enhanced cyber-focused regulations in 2023 to promote the financial sector's resilience against such threats.

SAMA has initiated key cybersecurity initiatives, which include the following:

- **Cyber-threat-led assessment for shared services**

This initiative helps identify, assess, and address strategic cyber scenarios that could target the financial sector; it performs the same function for strategic and asset-specific risks. It is carried out across the shared services being deployed and used by local financial entities. The outcome of the assessments will be leveraged to enhance cyber regulations for the financial sector.

- **Cybersecurity thematic assessment for member organizations**

SAMA Cyber Risk Control (CRC) has initiated a financial sector-wide cyber assessment in line with existing cybersecurity regulations to assess the maturity of financial entities and to provide a road map to improve their overall cyber resilience.

- **Sectorial cyber-risk profiling**

SAMA has developed an oversight process to formulate a risk profile at an entity and sectorial level, for those operating under SAMA's supervision. This initiative is being rolled out to formalize financial entities' cyber-risk profiles based on their cyber exposure and systemic relevance of the financial entities to the local market, with an overall aim of being proactive in protecting the Saudi financial sector and increasing its cyber resilience.

SAMA's efforts continued in mitigating risks faced by financial institutions related to external service providers continued.

SAMA addresses cyber risks associated with third-party relationships predominantly through regulatory requirements such as cybersecurity, IT governance, and business continuity frameworks. A vulnerability at one provider could also have a simultaneous impact on multiple financial institutions. Moreover, third-party vulnerabilities can result in cyber incidents that could lead to fraud and unauthorized access to customer or corporate sensitive information, which in turn could affect the soundness of the financial system. As part of its supervisory practice, SAMA performs thematic reviews to assess the risk exposure of these entities with respect to third-party relationships. Financial institutions report cyber incidents to SAMA immediately when a medium- or high-risk classified cyber incident has occurred and is identified. In such cases, SAMA analyzes incidents and related evidence to assess whether corrective actions have been taken by the financial entities or if additional on-site review should be performed to ensure the adequacy of measures taken to contain and mitigate the root cause of the incident.

The cybersecurity measures implemented by SAMA in 2023, building on those from previous years, are sufficient to maintain the strength of the financial system and mitigate the potential risks stemming from cyberspace.

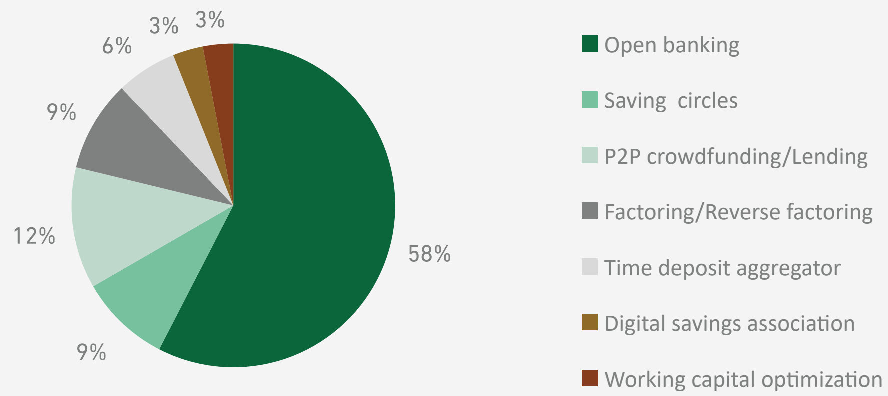
Box 5.1: Regulatory Sandbox

SAMA has been proactive in supporting the growth of the Fintech industry. SAMA's support for the Fintech sector can be traced back to 2018, when it launched its Regulatory Sandbox environment. This initiative supports the objectives of the national Fintech Strategy, introduced in mid-2022, and aims to provide a framework in which Fintech startups test their innovative ideas and concepts in a controlled environment for a specific period. By doing so, SAMA helps to create an ecosystem conducive to the growth of the Kingdom's Fintech industry.

In 2023, there were 33 Fintech companies under the Regulatory Sandbox umbrella — 16 companies were operating in the Sandbox and another 17 secured initial approval. In addition, there were 22 Fintech companies that graduated from the Sandbox and obtained full license by the end of 2023. The Regulatory Sandbox has also informed changes in current regulations and the introduction of completely new regulations. It is worth noting that among the permitted Fintech activities in the Sandbox, open banking has the highest share at 58%, followed by P2P crowdfunding/lending at 12% (Chart A).

In addition to the Sandbox operations outlined above, the cybersecurity unit within the Sandbox risk team provides guidance to the Fintech companies enrolled in the Regulatory Sandbox about existing SAMA cybersecurity regulations and validates compliance with these regulations before onboarding. This contributes to enhanced cybersecurity awareness and improves compliance culture.

Chart A: Percentage of Permitted Fintech Activity in the Regulatory Sandbox, 2023



Source: SAMA

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