



بنك الإمارات دبي الوطني
Emirates NBD

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Interest Rate Monitor – SAMA raises policy rates

Late last week, Saudi Arabian Monetary Authority (SAMA) raised its policy rates by 25bps with immediate effect, bringing the repo rate to 2.25% and the reverse repo rate to 1.75%. Deviating from the usual practice of following rate moves of the US Federal Reserve, SAMA stated that the policy rate adjustments are required for monetary stability in the evolving domestic and international monetary conditions. While the reverse repo rate was being raised in step with U.S. rate changes over the past two years, this is the first time, since 2009, that the SAMA has changed the repo rate.

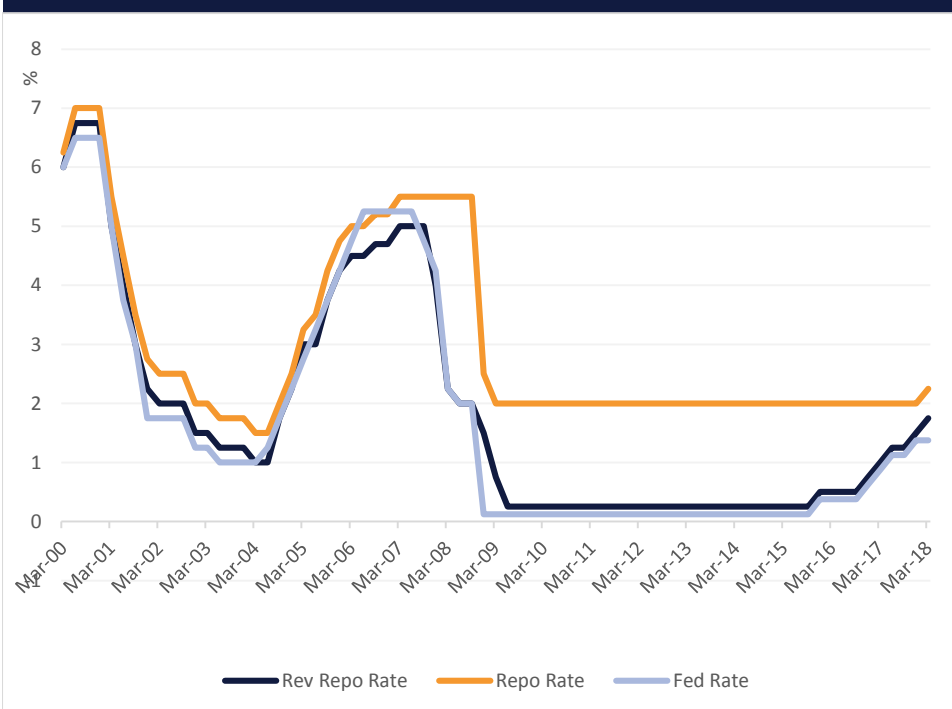
Earlier this month, SAMA had also decided to suspend term repo facility for maturities of 7, 28 and 90 days, citing the decision to be reflective of recent market developments in the context of maintaining monetary stability. These extended REPO facilities were introduced in 2016 during a period of tight liquidity in the banking system caused by low oil prices. Since then, liquidity has increased significantly as oil prices increased and the government turned to international bond sales.

Narrowing SAIBOR - LIBOR Spreads

The current rate hike move by the SAMA is probably motivated by concerns over the risk of capital flight as the Saudi 3-month interbank rate fall below the USD LIBOR. After touching a high of positive 156bps in mid-2016, the 3m SAIBOR spread over LIBOR turned negative -18bps last week.

The two main factors contributing to this are: a) abundant liquidity in the local Saudi banking system driven by high deposit growth due to oil prices averaging above \$60/b and anaemic loan growth in the face of economic contraction last year, and b) an unprecedented increase in LIBOR rates driven partly by high issuance of short term securities by the US government.

KSA policy rates vs the Fed Target Rate

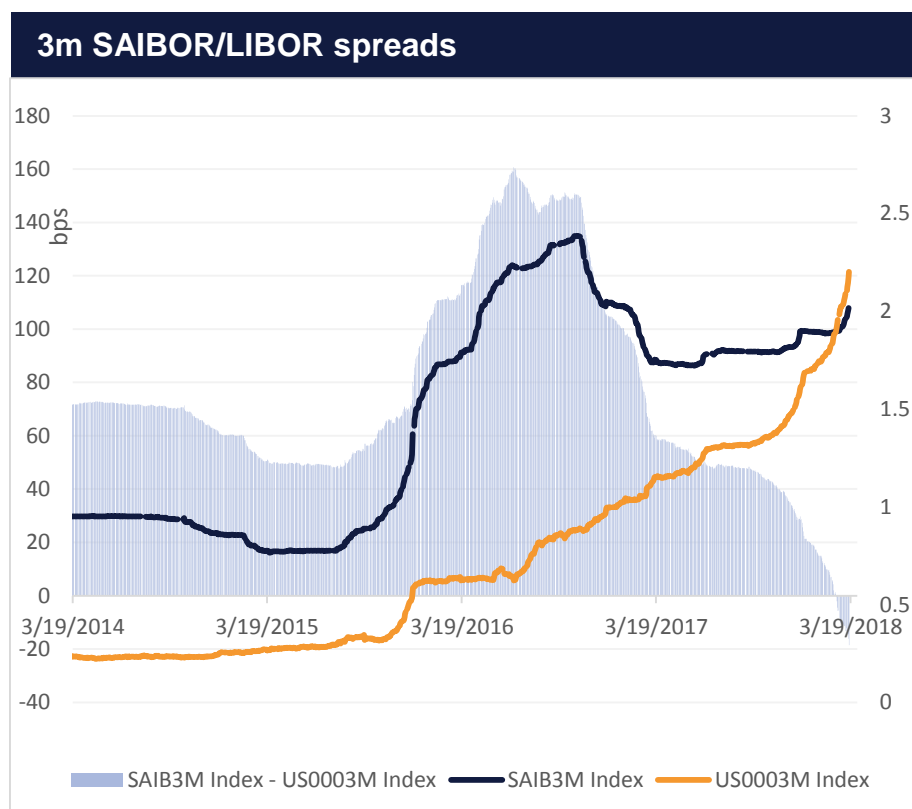


Source: Bloomberg, Emirates NBD Research

The SAIBOR spread had fallen below the USD LIBOR last time in 2006/2007. Although fast pace of rate hikes in the US in 2005 caused LIBOR to rise faster than SAIBOR then, the main factor causing negative SAIBOR/LIBOR spread was largely the speculative inflow of foreign capital triggered by anticipation of currency revaluation. However this time around, it is more domestic in nature. Unlike now, there was no major fear of capital outflow then. The negative spread situation reversed in late 2008 as LIBOR spreads spiked during the financial crisis.

Given the expectations of low economic growth, high liquidity in the Saudi banking sector may not reduce and this may continue to keep SAIBOR rates low, thereby prompting SAMA to consider monetary policy measures to boost interbank rates.

In Saudi Arabia, the exchange rate plays a crucial role in monetary policy. It is an important variable for price stability and the balance of payments. Intervention policy under the fixed exchange rate regime is influenced by the level of foreign exchange outflow and the dollar/riyal interest rate differential.



Source: Bloomberg, Emirates NBD Research

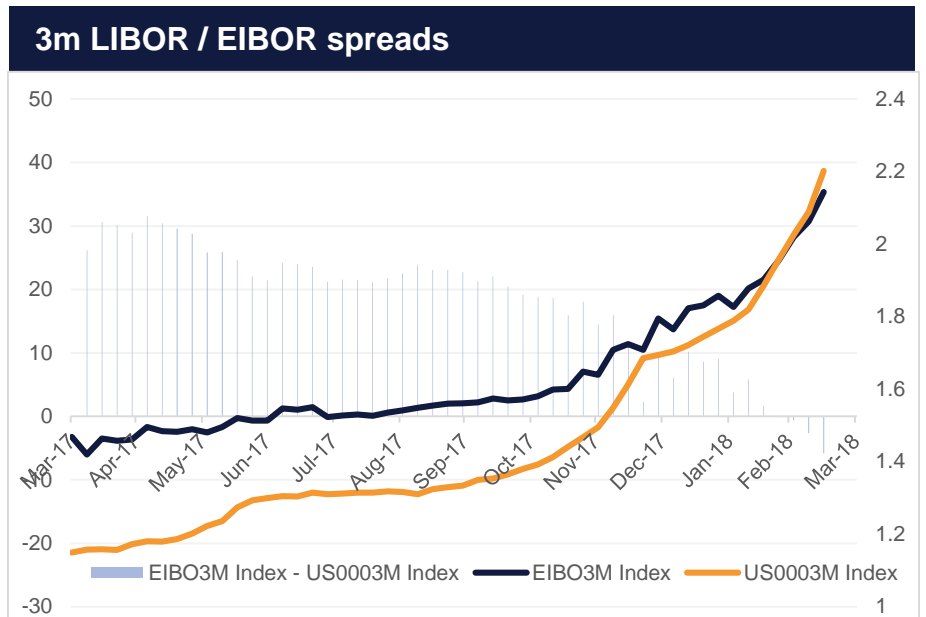
The current move by SAMA is likely to have been driven by a need to ensure the appeal of SAR in an environment of generally tightening monetary conditions in the developed world. Although the SAR is pegged to the dollar, it virtually floats against non-dollar currencies.

SAMA's preferred range for the difference between the lending and borrowing rate is 50bps or higher. Looking ahead we expect future rate hikes to impact both Repo and Reverse Repo rates.

The US Federal Reserve is expected to raise rates at its meeting on 21st March. We expect SAMA to raise both the repo and reverse repo rates in tandem with the Fed, however, **this pre-emptive move by SAMA introduces some uncertainty regarding the timing of its next hike.**

UAE Rates

Interbank rates in the neighbouring UAE also reflect negative spread between the 3m EIBOR and LIBOR, also caused by the abundant liquidity and also expected to remain unchanged at least until the temporary hike in LIBOR rates fades in a quarter or two.



Source: Bloomberg, Emirates NBD Research

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