

SAMA, Monetary Policy and Interest Rates

Saudi Arabian Monetary Agency (SAMA)

- Central bank of Saudi Arabia
- Was established in 1952

Functions

- To deal with the banking affairs of the government
- Minting and printing the national currency, strengthening the Saudi currency and stabilizing its external and internal value, in addition to strengthening the currency's cover
- Managing the Kingdom's foreign exchange reserves

Functions

- Managing the monetary policy for maintaining the stability of prices and exchange rate
- Promoting the growth of the financial system and ensuring its soundness
- Supervising commercial banks and exchange dealers
- Supervising cooperative insurance companies and the self-employment professions relating to the insurance activity

Functions

- Supervising finance companies
- Supervising credit information companies

Balance sheet of SAMA

- **Liabilities:**
- Notes issues
- Government deposits
- Commercial banks' deposits
- Foreign entities' riyal deposits

Balance sheet of SAMA

- **Assets:**
- Currency cover (gold)
- Cash in vault
- Deposits with banks abroad
- Investments in foreign securities

MONETARY POLICY INSTRUMENTS

Monetary policy instruments

- 1. Cash reserve ratio
- 2. Repos and reverse repos
- 3. Foreign exchange swaps
- 4. Placement of public funds

Monetary policy instruments

- Applies no direct control particularly with respect to control of interest rates and foreign exchange.
- SAMA's charter prohibits the payment and receipt of interests
- SAMA has adopted a regime of free movement of capital

Monetary policy instruments

- Does not use credit ceilings
- But imposes credit concentration ceilings on certain economic sectors

Cash reserve ratio

- Under Article 7 of the Banking Control Law, banks are required to maintain a percentage of their customers' deposits with SAMAs as prescribed cash reserves.
- Designed both as monetary policy and to ensure that the banks have adequate liquidity to cover their customers' deposits.

Cash reserve ratio

- Most powerful instrument of liquidity policy available to SAMA
- However, it has been applied only for implementing structural changes in bank liquidity (credit creation control) rather than for the frequent fine-tuning of short-term liquidity

Statutory liquidity ratio (SLR)

- Under Article 7 of the Banking Control Law, banks are required to maintain a minimum amount of specified liquid assets equal to 20% of their demand and time liabilities (known as the statutory liquidity ratio).

Statutory liquidity ratio (SLR)

- As a result of the application of the reserve ratios, the free liquidity at the disposal of the banks at any time for lending is the difference between total deposits and the aggregate of the sums constituting the cash reserve ratio and the statutory liquidity ratio.

Repo

- This arrangement permits a very short-term injection of reserves and their automatic withdrawal when the repos mature. The allocation of repos is linked to banks' holdings of eligible securities (government development bonds, FRNs and Treasury bills).

Reverse repo

- In situations where there is a temporary need to absorb, rather than provide, bank reserves, SAMAs engages in overnight reverse repos (matched sale-purchase operations) with banks.

Open market operations

- Open market operations are a flexible instrument of credit control whereby a central bank, on its own initiative, alters the liquidity position of banks by dealing directly in the market instead of using its influence indirectly by varying the cost of its credit

Open market operations

- Efficacy of open market operations depends on central bank holdings of securities and the size and depth of the market.
- In situations that call for only temporary additions to bank reserves, SAMA engages in short-dated repurchase agreements (predominantly overnight repos) with banks

Foreign exchange swaps

- Serve the purpose of influencing capital flows, thereby reducing the disruptions to monetary policy emanating from the foreign exchange market

Placement of public funds

- As part of its regular money market operations, SAMAs exercise their discretion in using the government institutions' funds at their disposal to place with the banks.
- Such placements of public funds are entirely at SAMAs' discretion and are complementary to the primary instruments for fine-tuning day-to-day liquidity (repos and foreign exchange swaps).

Placement of public funds

- Basically, however, the placement of funds is to be seen as providing longer-term liquidity support (gross or rough-tuning).

Monetary policy

- Expansionary:
 - Open market purchases of securities by SAMA
 - Reserve requirement ratio decreases
- Contractionary:
 - Open market sale of securities by SAMA
 - Reserve requirement ratio increases

Impact of monetary policy on various economic variables

| | <i>Expansionary activities</i> | <i>Contractionary activities</i> |
|---------------------|--------------------------------|----------------------------------|
| Reserves | increase | Decrease |
| Credit availability | increase | Decrease |
| Money supply | Increase | Decrease |
| Interest rates | Decrease | Increase |
| Security prices | increase | decrease |