

# Financial Deepening

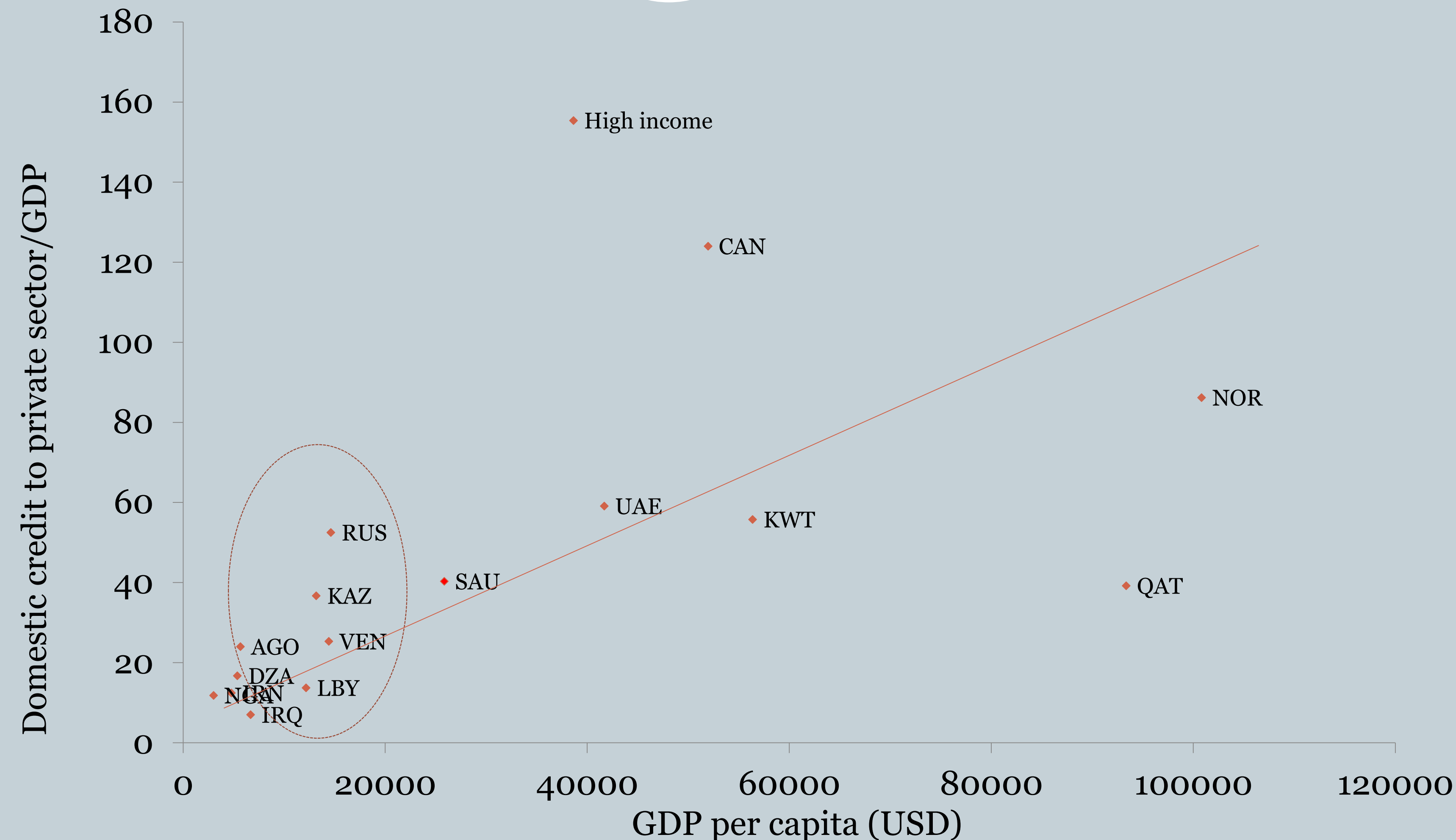
Your  
global  
future  
**begins**  
here

College of  
Business & Finance

**Dr. Abdullah AlHassan and Dr. Ali Alsadiq**

# Financial depth is relatively low

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# Roadmap

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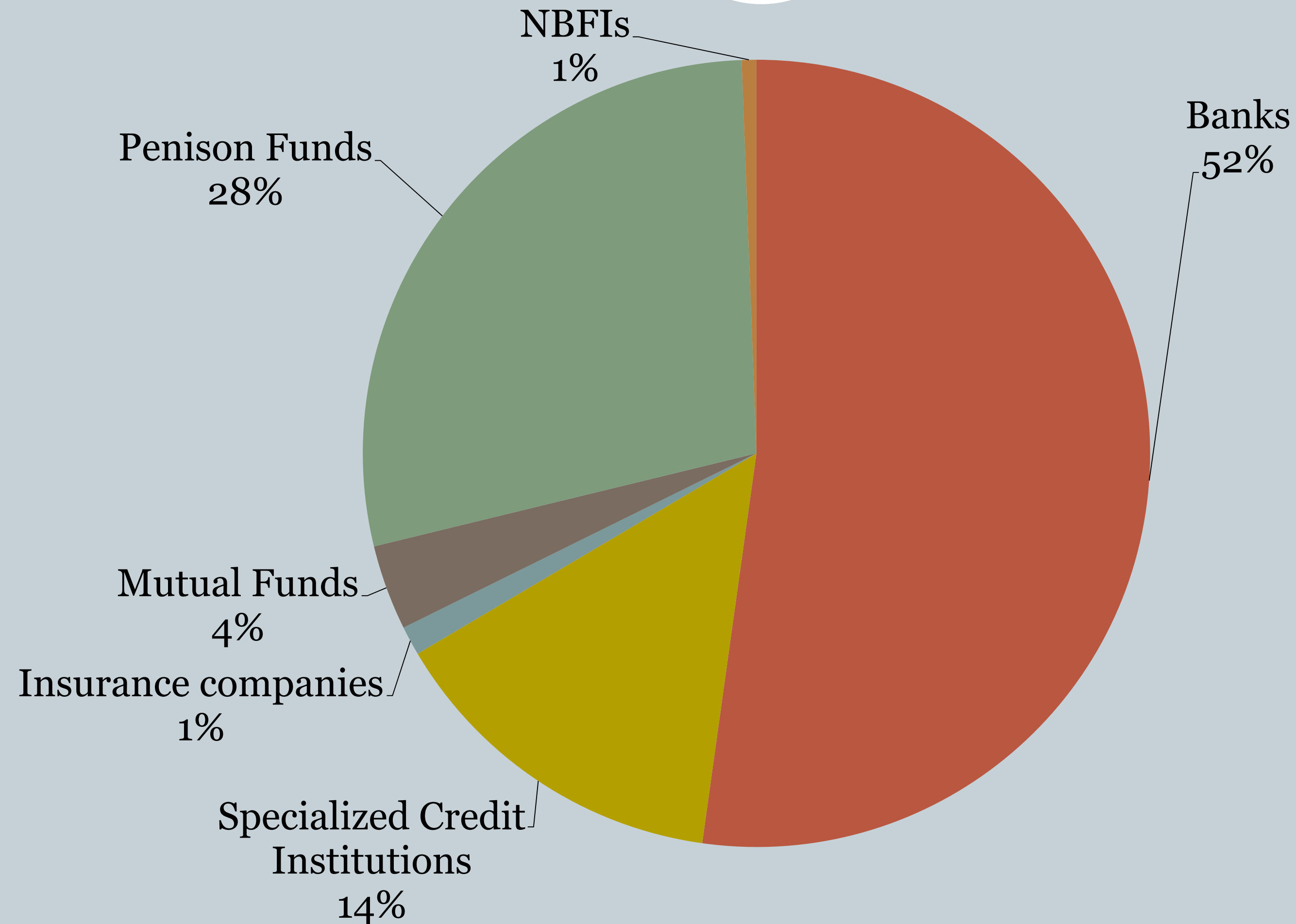
- Finance-Growth nexus literature
- Stylized facts about the financial system
- Research objectives
- Assessing financial deepening
- Key messages and policy implications
- Next steps

# First: What we know from literature.

- Finance-growth nexus: vast literature showing financial development is associated with higher rates of economic growth
  - *Theoretical perspective*: among others, Mckinnon (1973), Shaw (1973) and Goldsmih (1969)
  - *Empirical evidence*: King and Levine (1993), Levine and Zervos (1998)
- Barajas *et al.* (2013) find that financial depth produces a lower growth in the MENA region compared to the rest of the world, due to strong state ownership, lack of competition, and weak financial reforms

# The financial system is fairly diversified, but dominated by banks

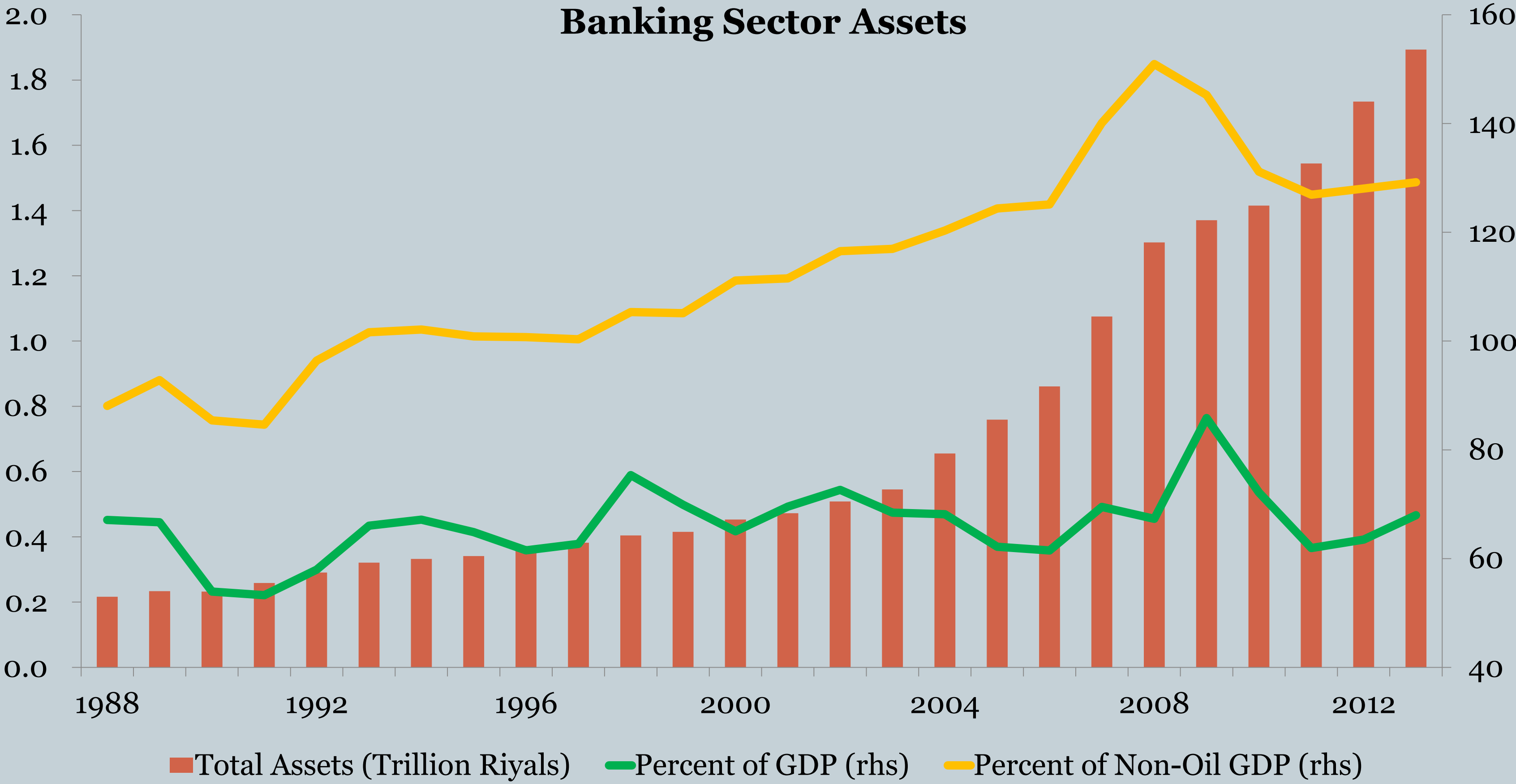
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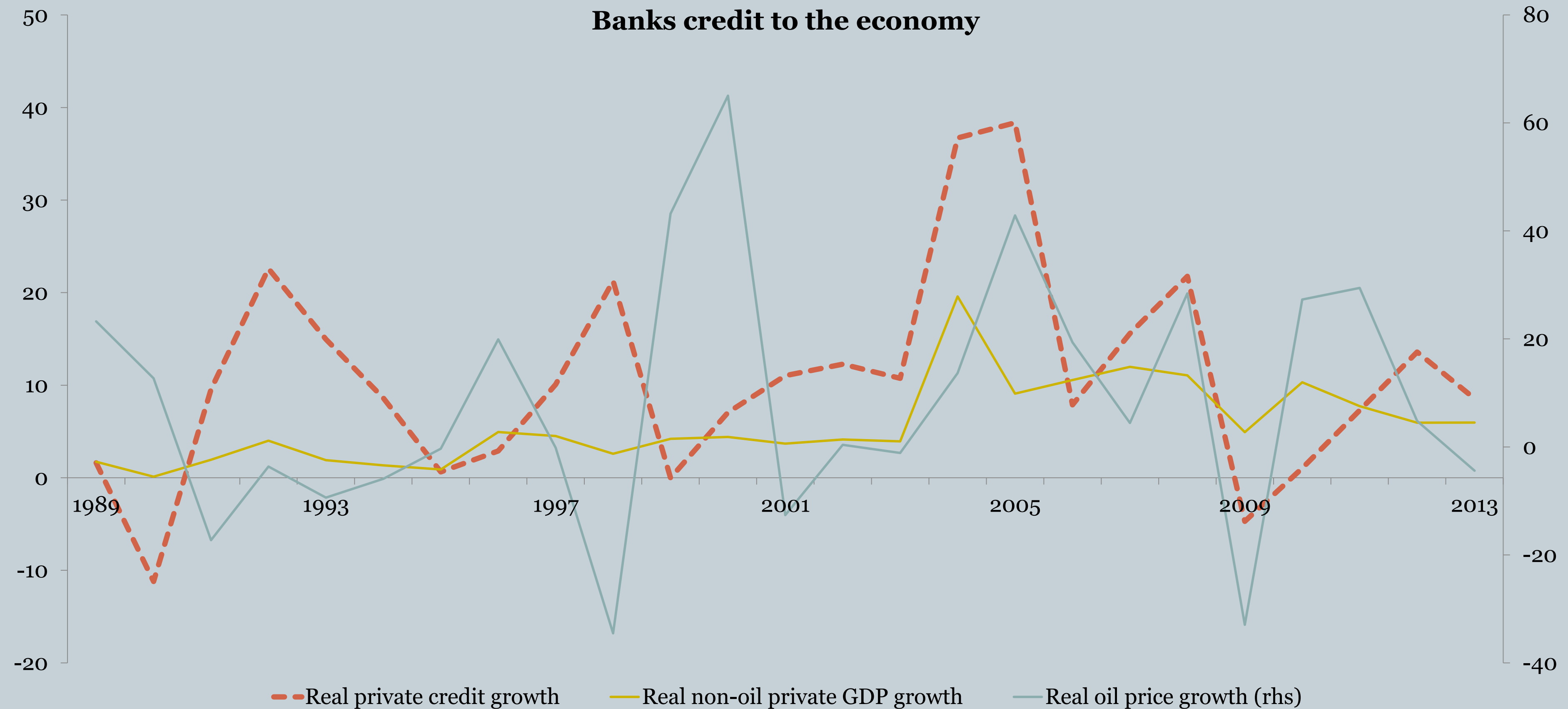
# The banking system has been grown steadily...

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# ...however, credit to the economy has been volatile

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# The key objectives are...

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- To benchmark Saudi Arabia's financial sector performance—in terms of access, depth, efficiency, and stability—over time and relative to other countries
- To engage policy makers in a diagnostic work to identify obstacles to further financial development for more:
  - Sustain and inclusive growth
  - Increase the effectiveness of macroeconomic policies



# What is financial deepening?

- **Depth:** the financial sector relative to the economy
- **Access:** the availability and quality of financial services
- **Efficiency:** the ability of the financial sector to provide high-quality products and services at reasonable costs
- **Stability:** whether there are any vulnerabilities that could trigger a liquidity or solvency crisis

# Financial indicators

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## Depth:

Private sector credit/GDP  
Domestic Banks' deposit/ GDP  
Broad money/GDP  
Stock market capitalization  
Number of list companies  
Pension funds assets /GDP

## Efficiency:

ROA  
ROE  
Net interest margin  
Noninterest income to total income  
3 Bank Asset Concentration  
Cost to income ratio  
Stock market turnover ratio

## Access:

Branches per 100,000 per adult  
Number of debit and credit cards  
Financing channels (formal vs. informal)  
The use of electronic payment

## Stability

Loan-to-deposit ratio  
NPLs  
Provision –to-total NPLs  
Liquid Assets  
Bank z-score

# Dataset

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## ➤ ***FinStats:***

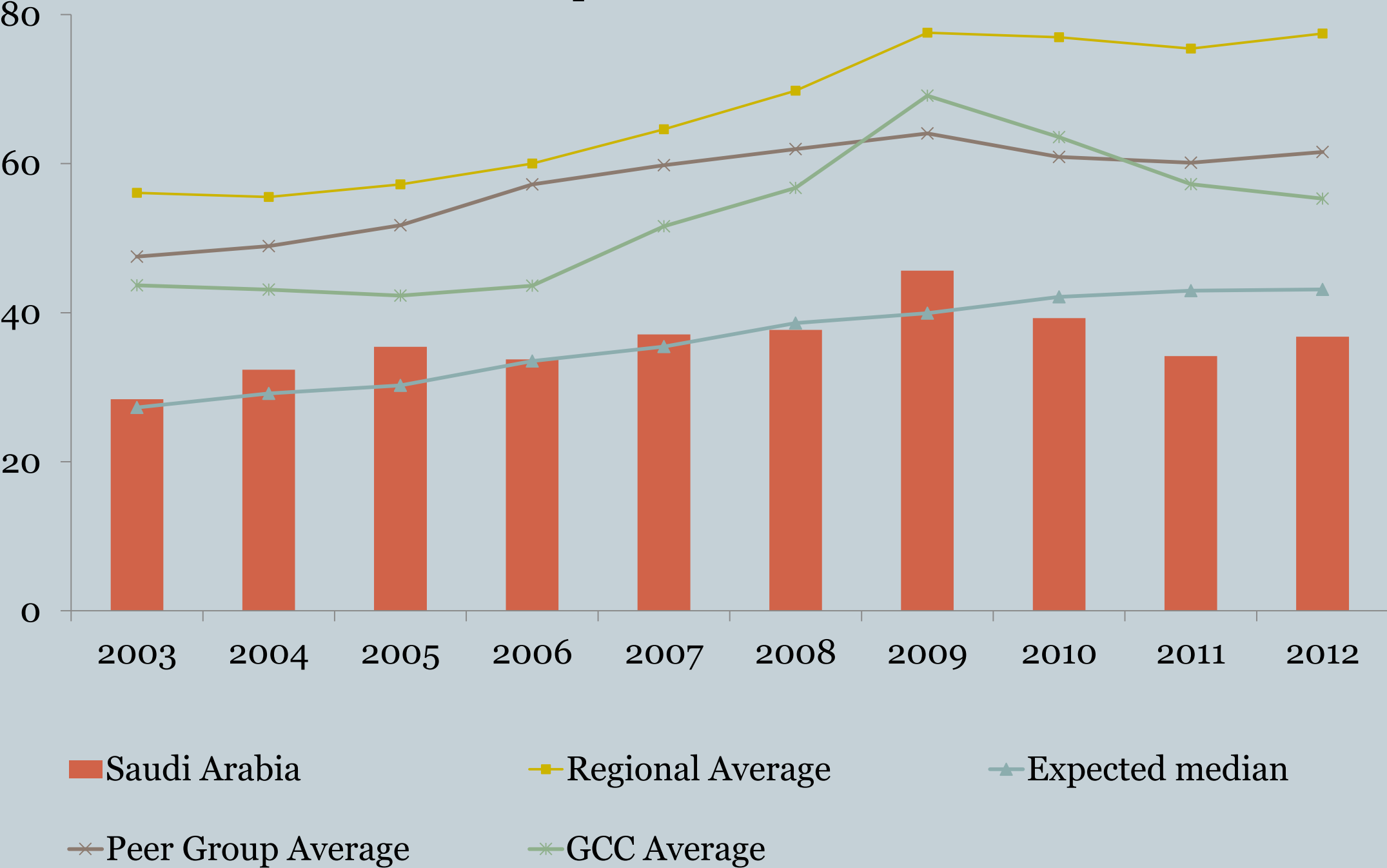
- Covers the banking sector, debt markets, equity markets, and non-bank financial institutions, with 42 financial sector indicators for over 180 countries
- Compares the performance of the financial system to a peer group countries and regional average
- Constructs a statistical benchmark based on the country's economic and structural characteristics (e.g., economic development, demographics, population)

## ➤ ***Findex:*** measures financial inclusion in 148 countries

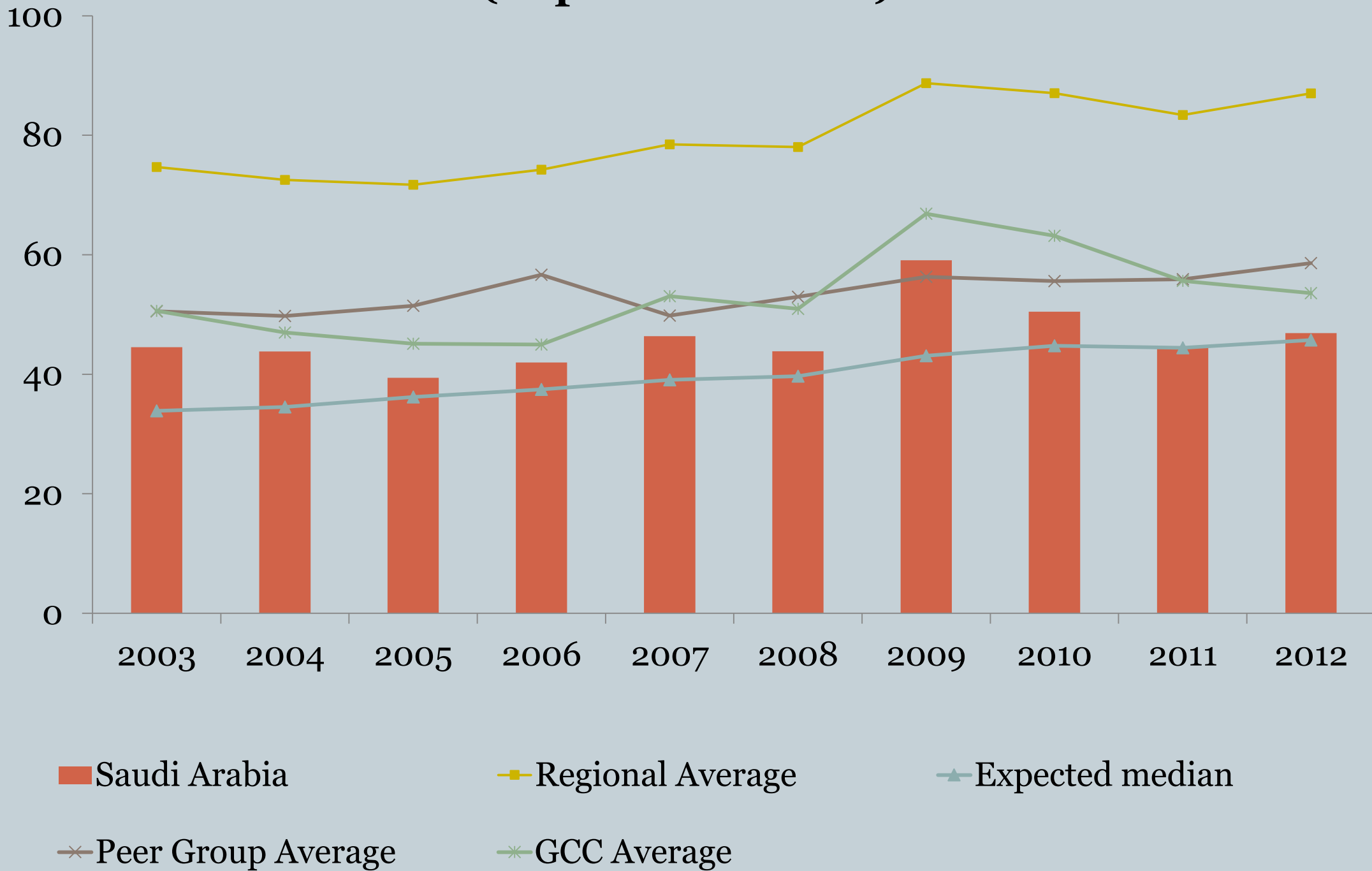
- The World Economic Outlook
- World Development Indicators

# Depth: Financial intermediation lags behind others, but along its fundamentals...

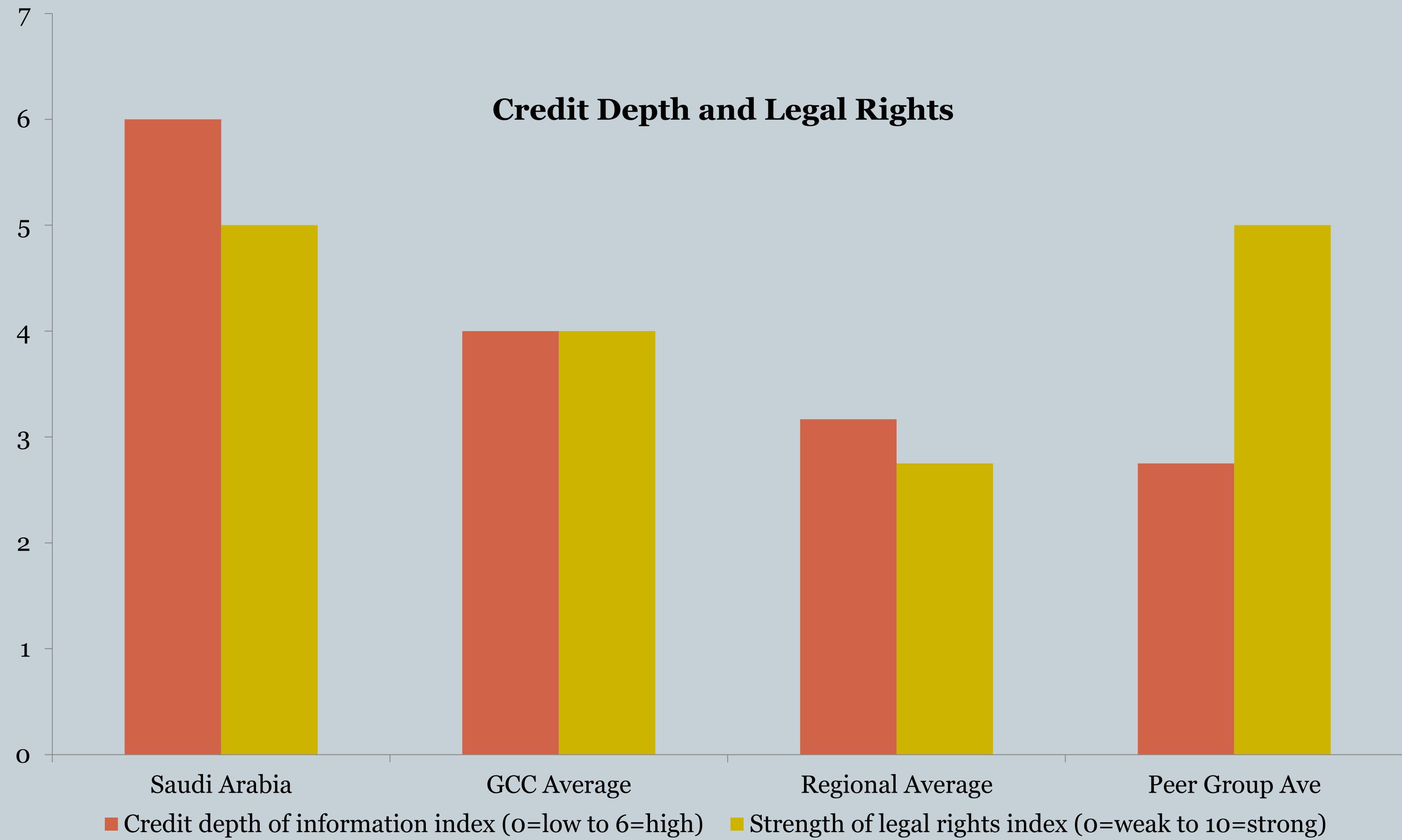
Private Sector Credit  
(In percent of GDP)



Domestic Bank Deposits  
(In percent of GDP)



# ...despite high quality of credit information and legal rights



# The size of the equity market is comparable

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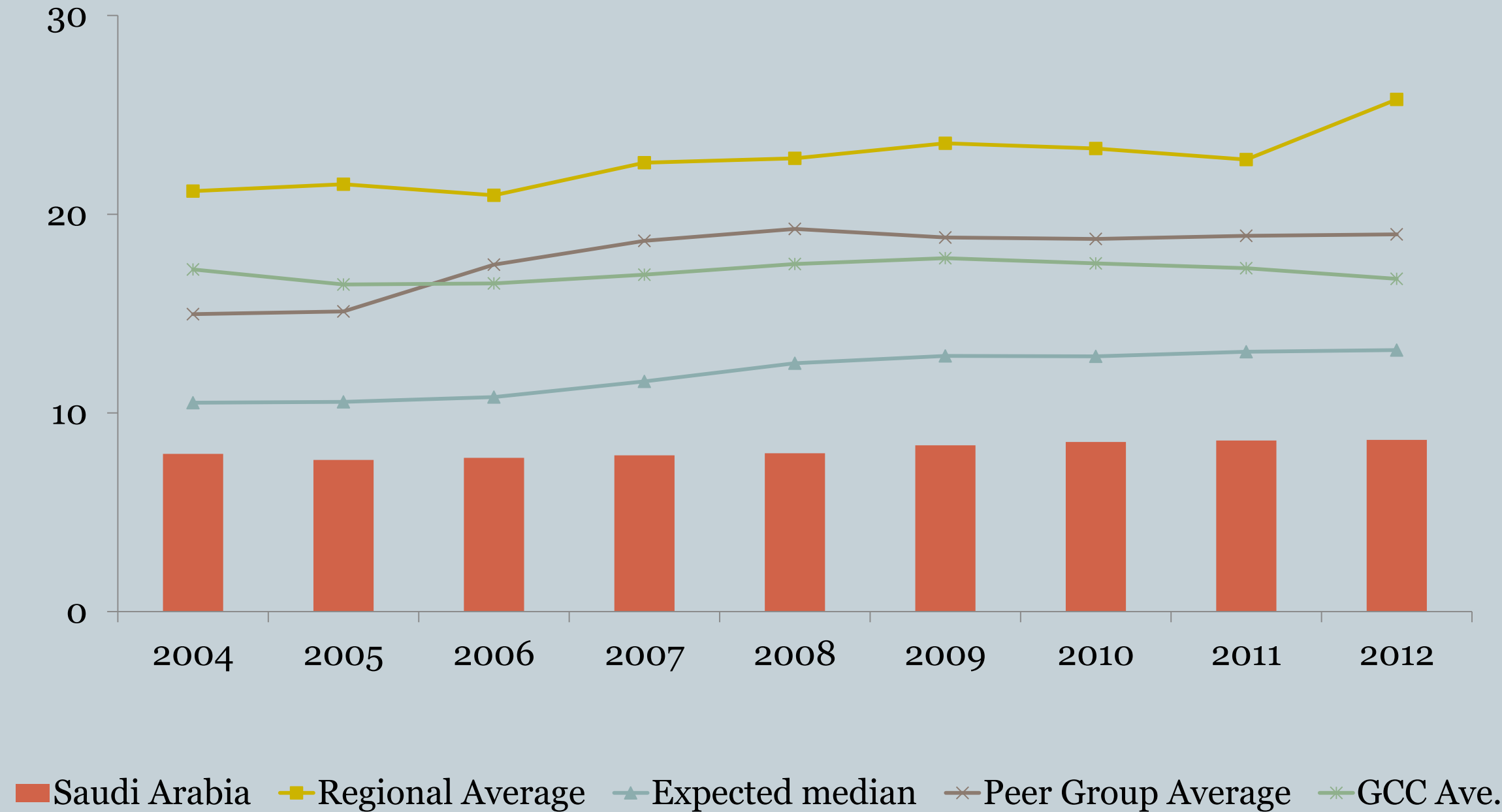




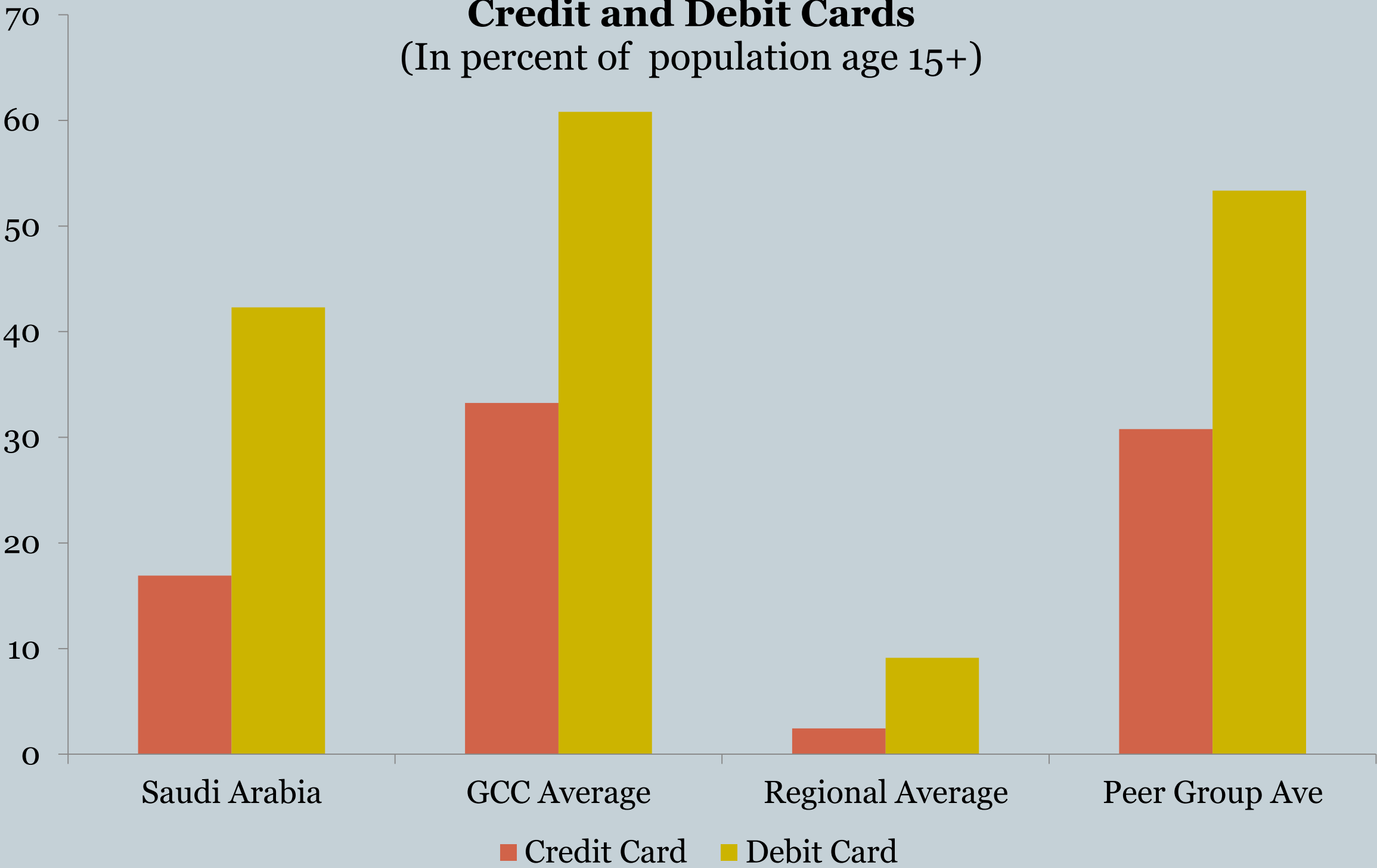
# Financial access lags behind...

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Number of Branches Per 100,00 Adults

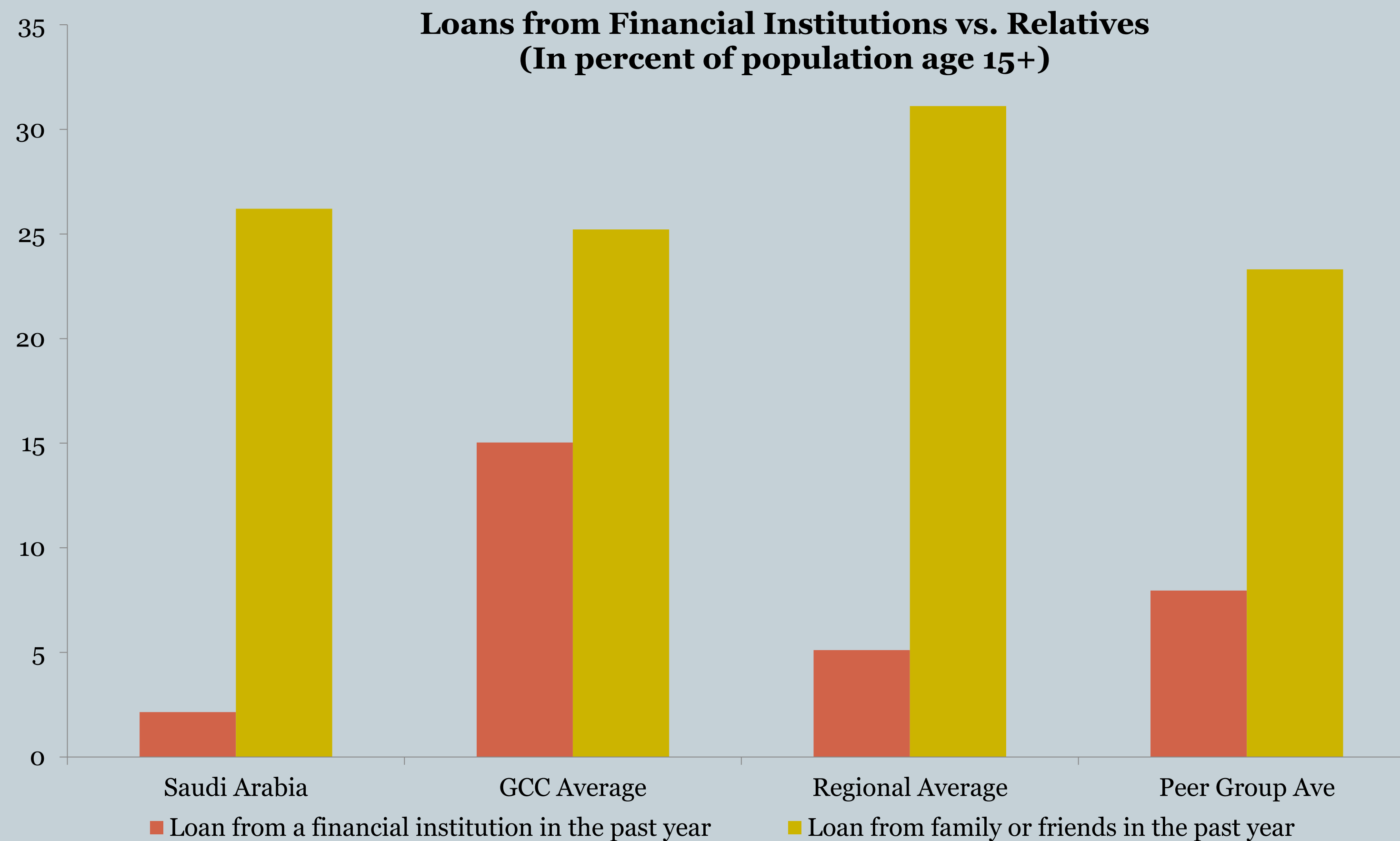


Credit and Debit Cards  
(In percent of population age 15+)



# ...and households rely on informal financing channels

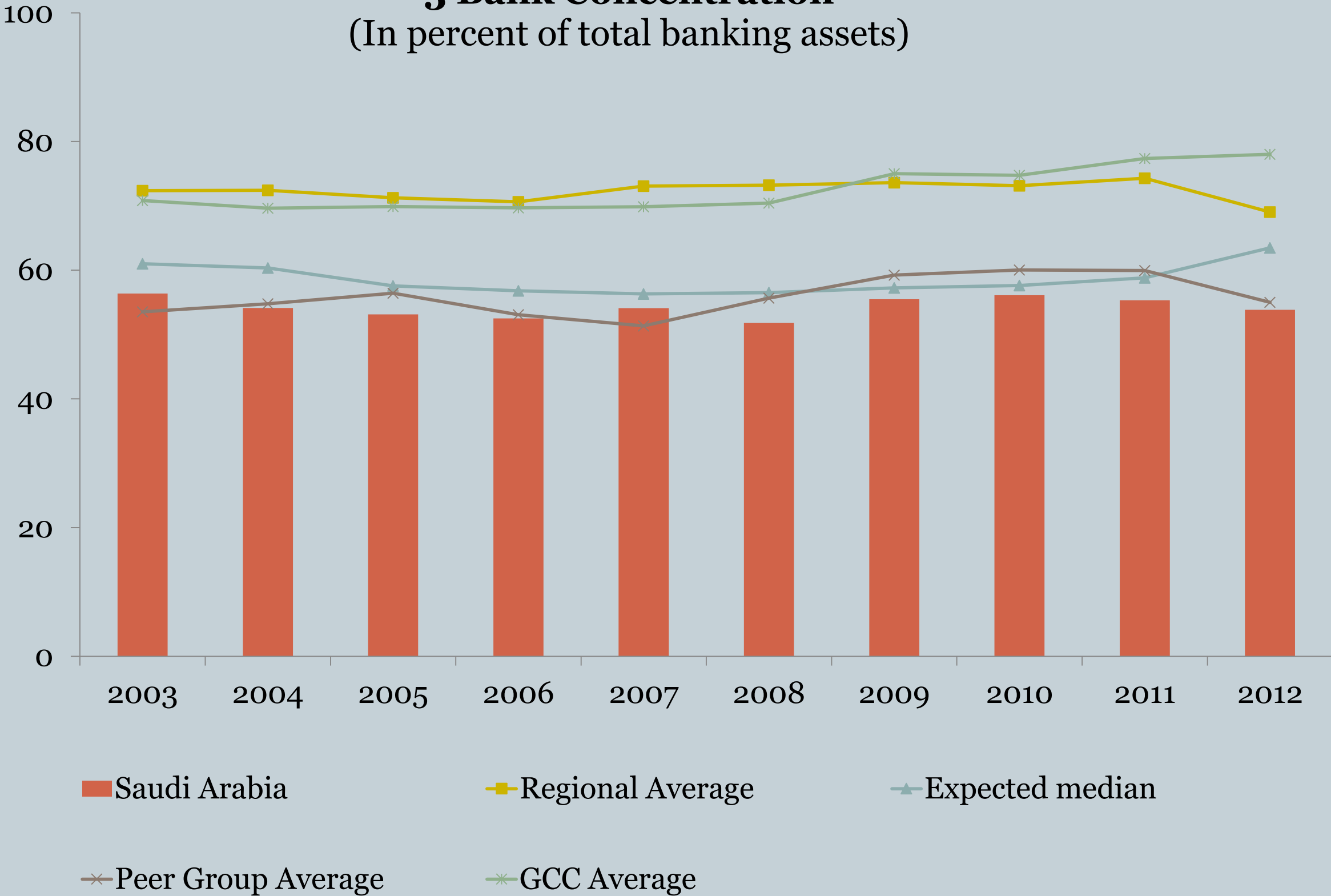
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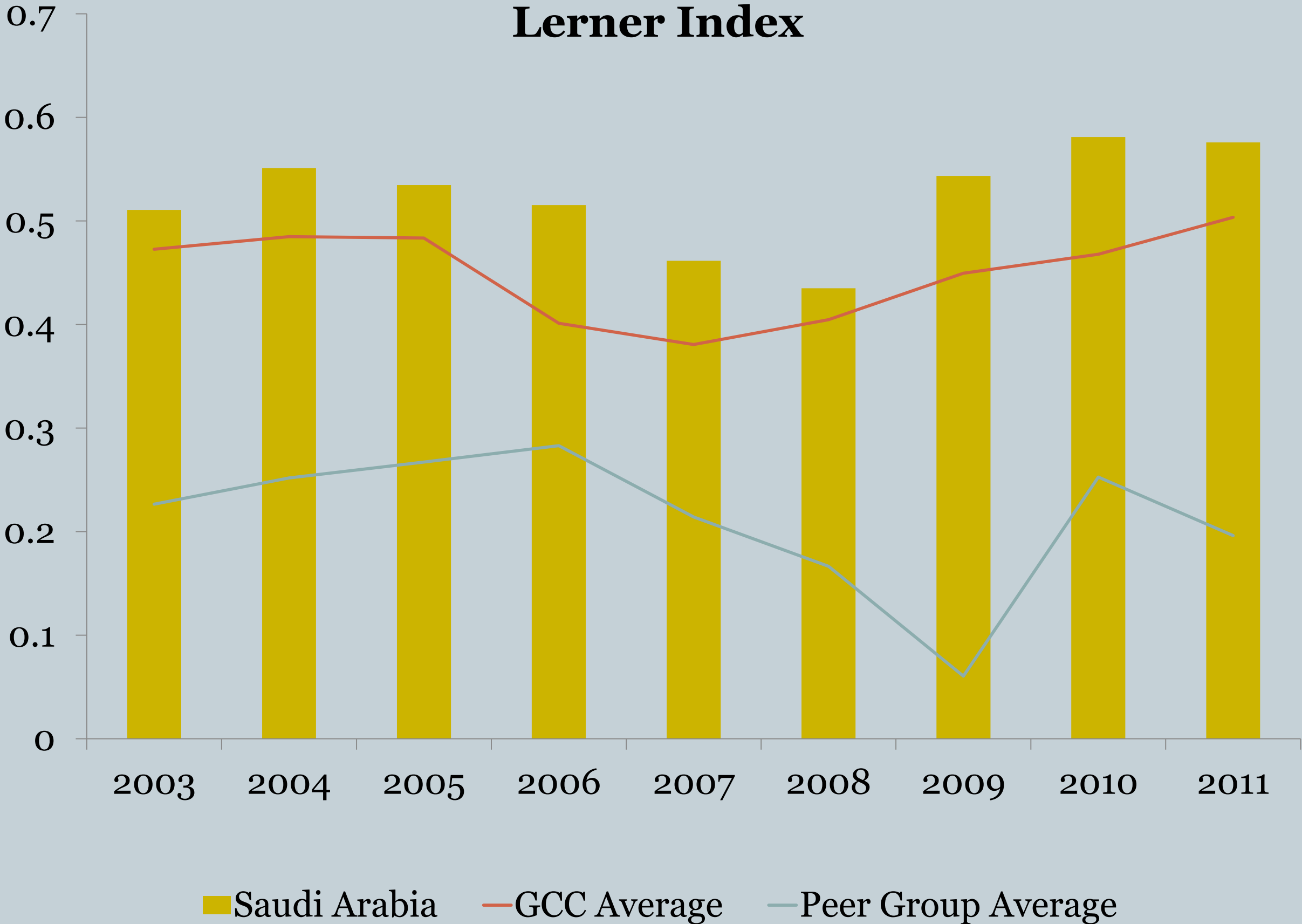
# Efficiency: Limited competition among banks...

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**3 Bank Concentration**  
(In percent of total banking assets)

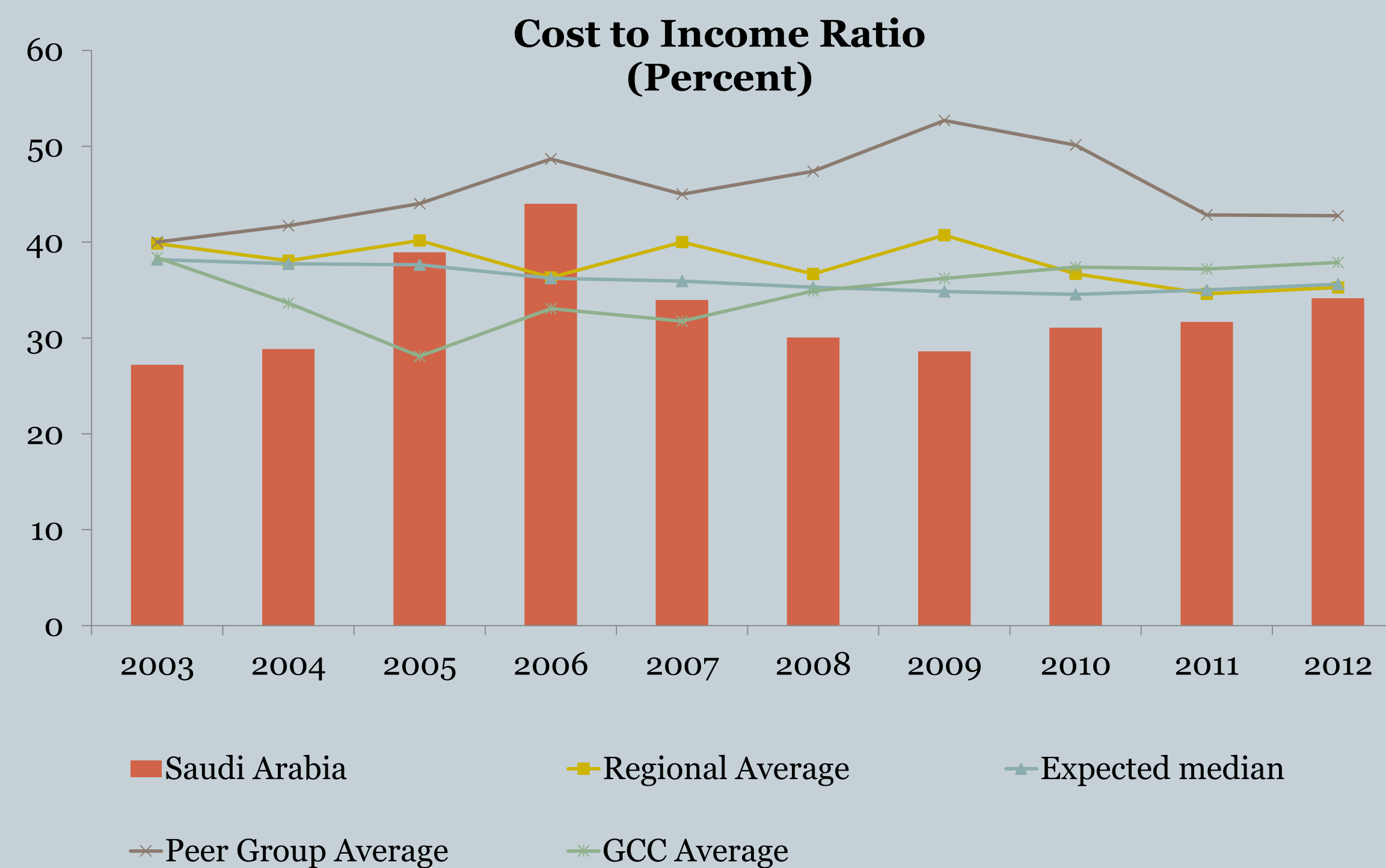
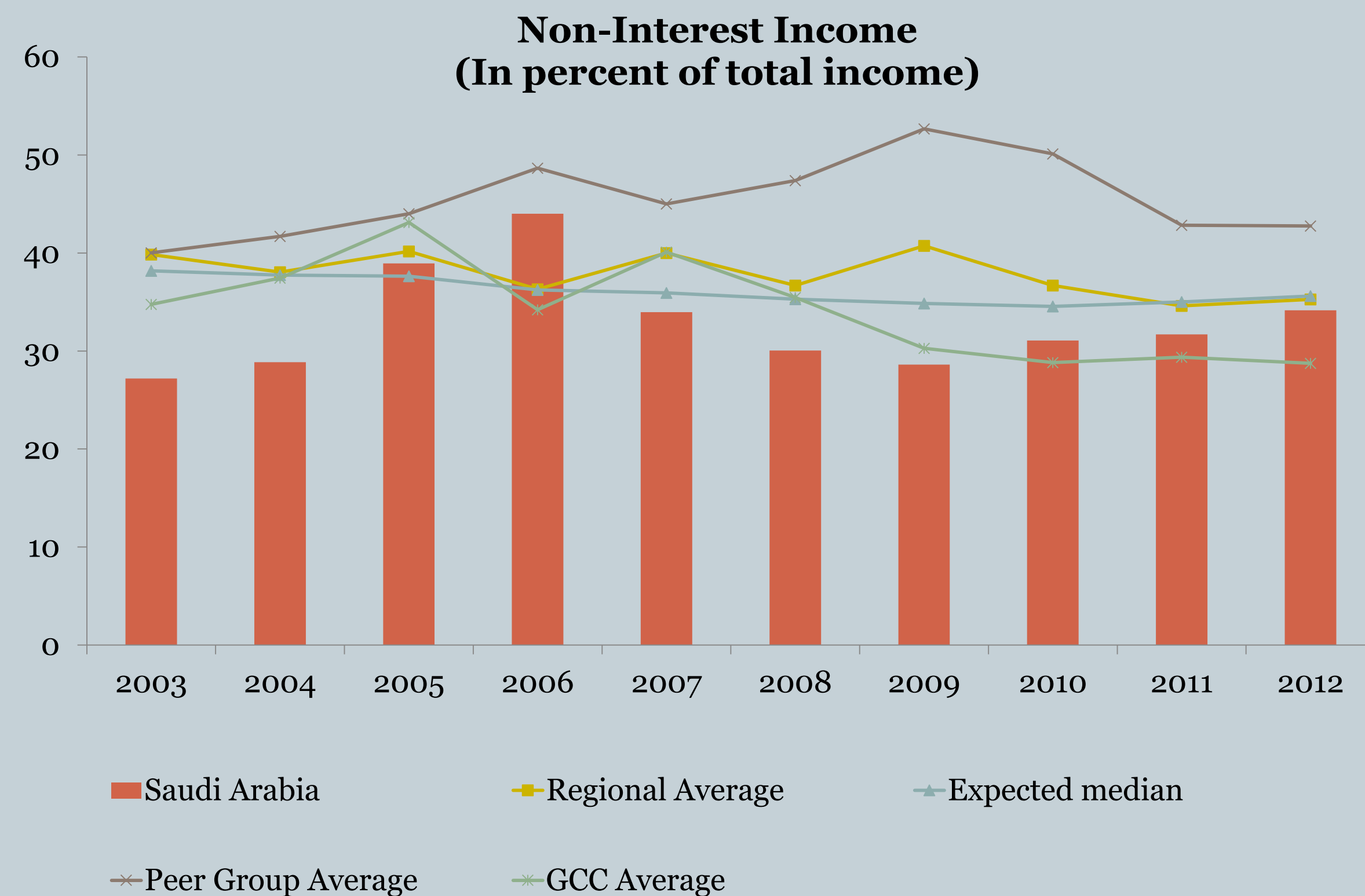


**Lerner Index**



# ...with lower operation costs...

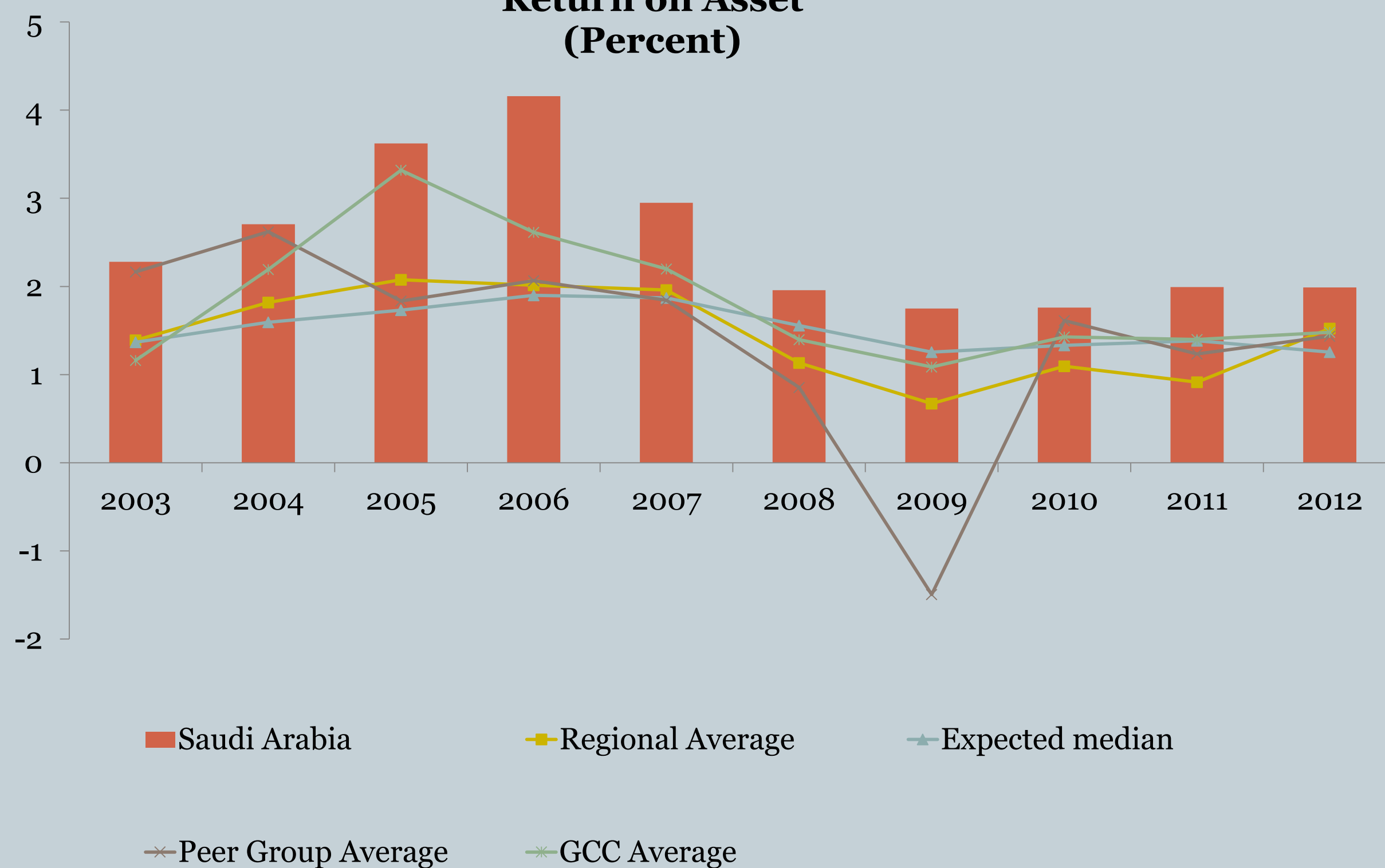
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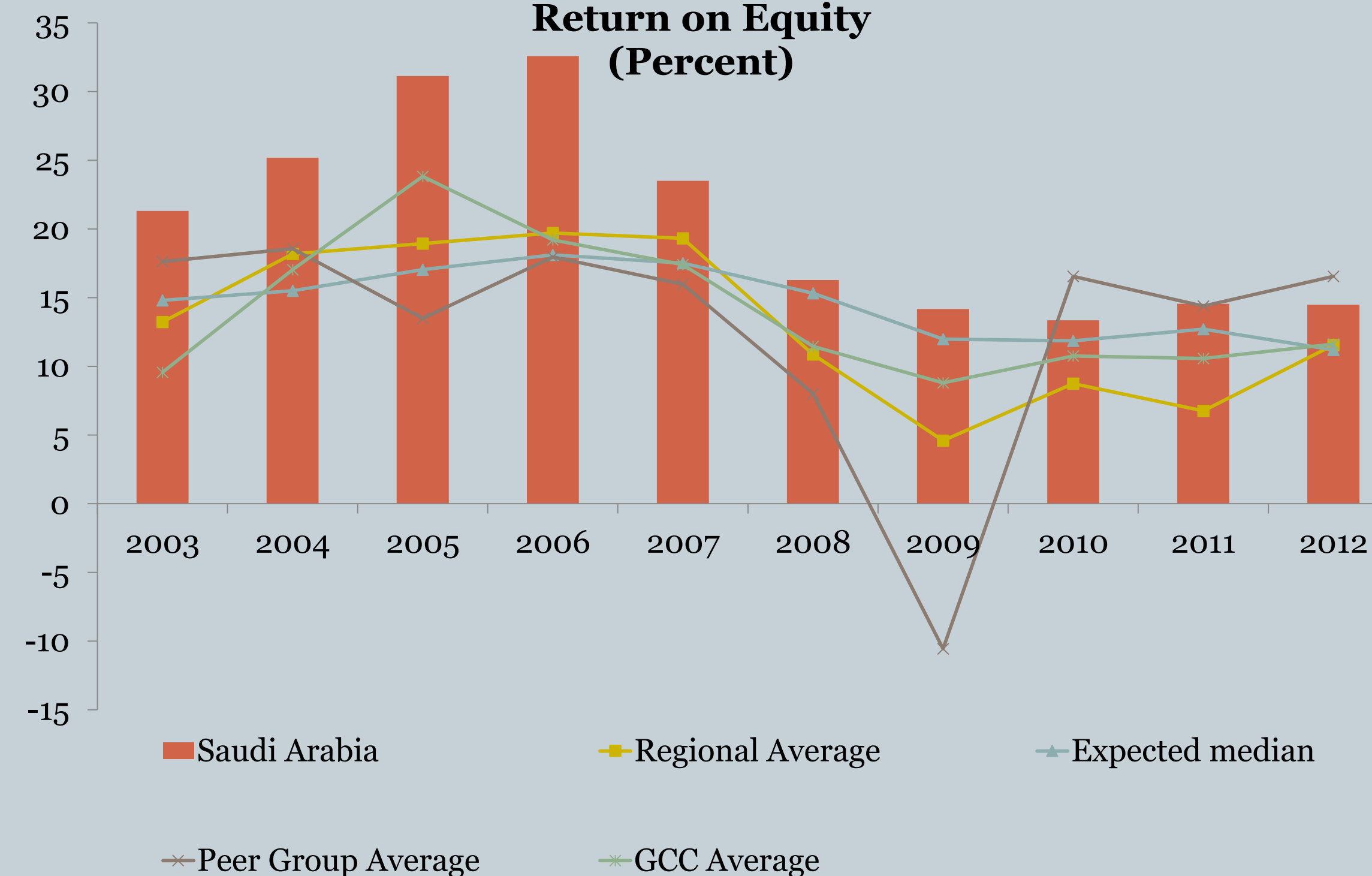
# ...and thereby leading to high profitability

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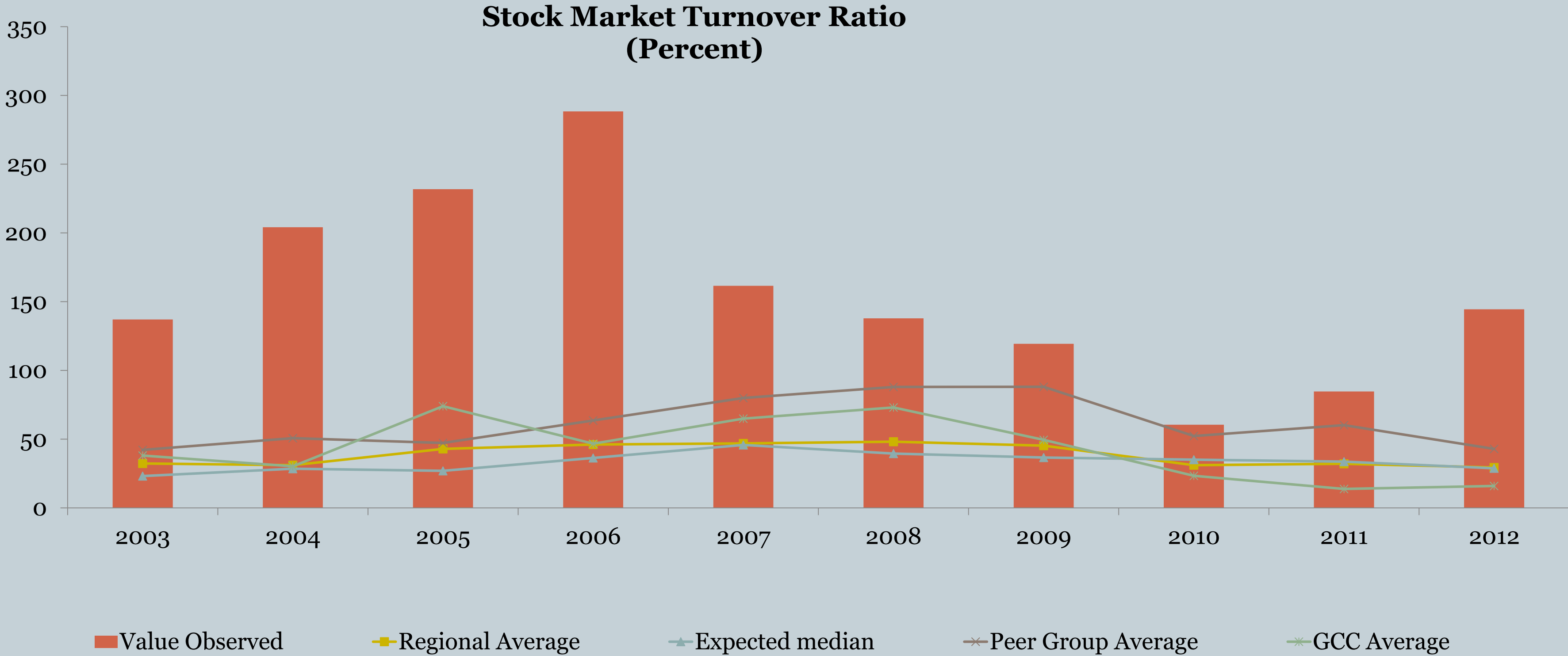
### Return on Asset (Percent)



### Return on Equity (Percent)

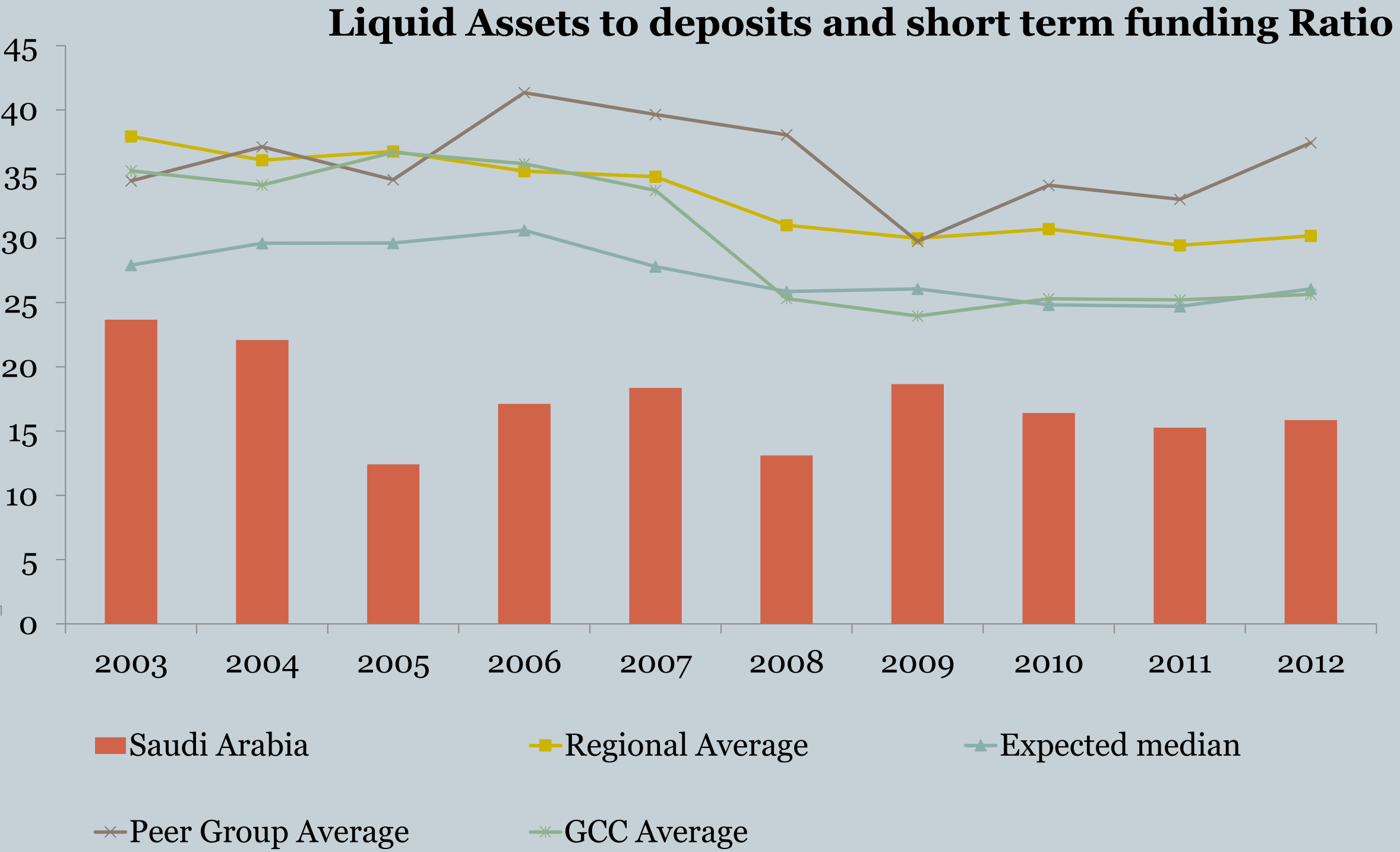
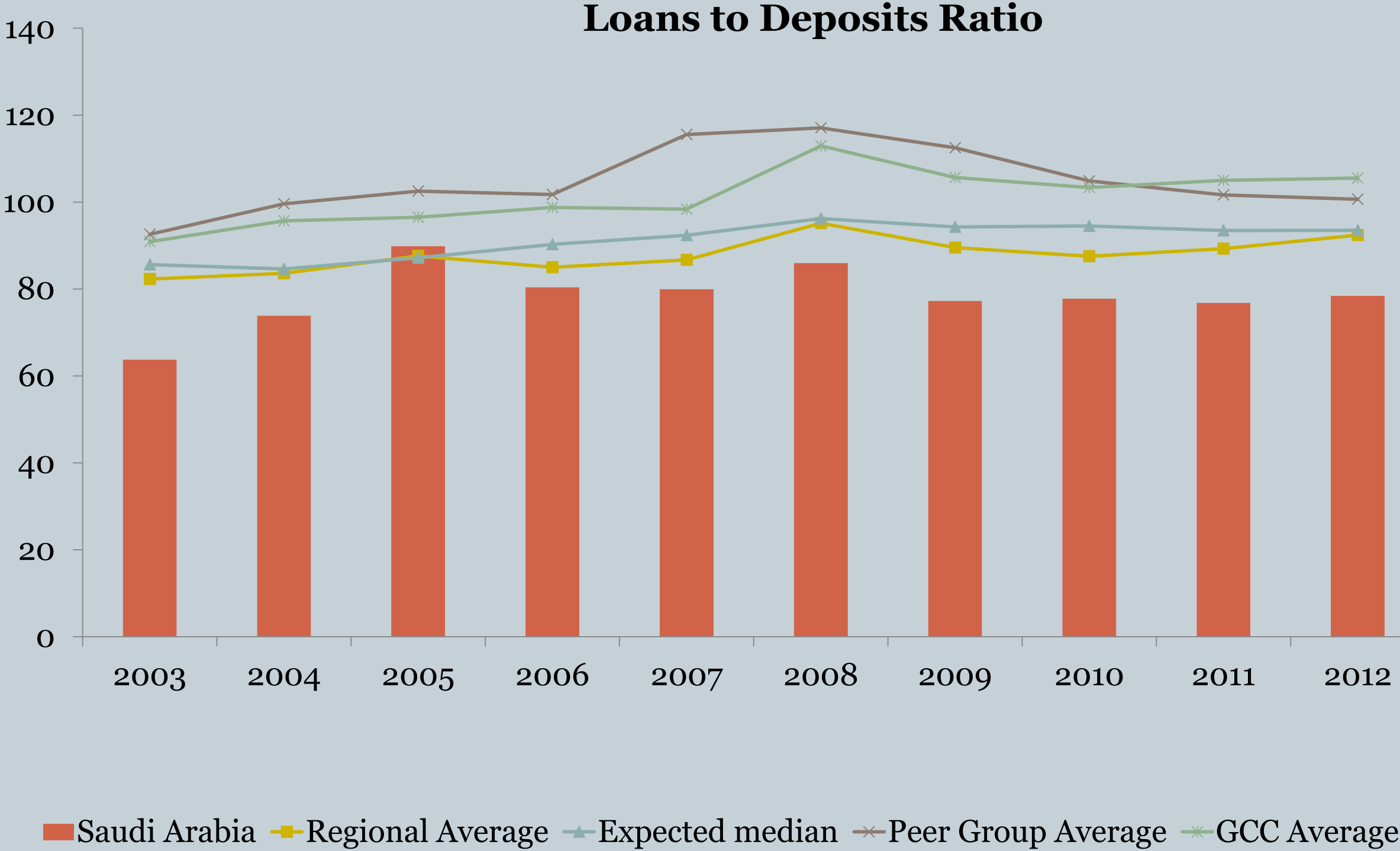


# Retail investors are the driving force behind stock market activity



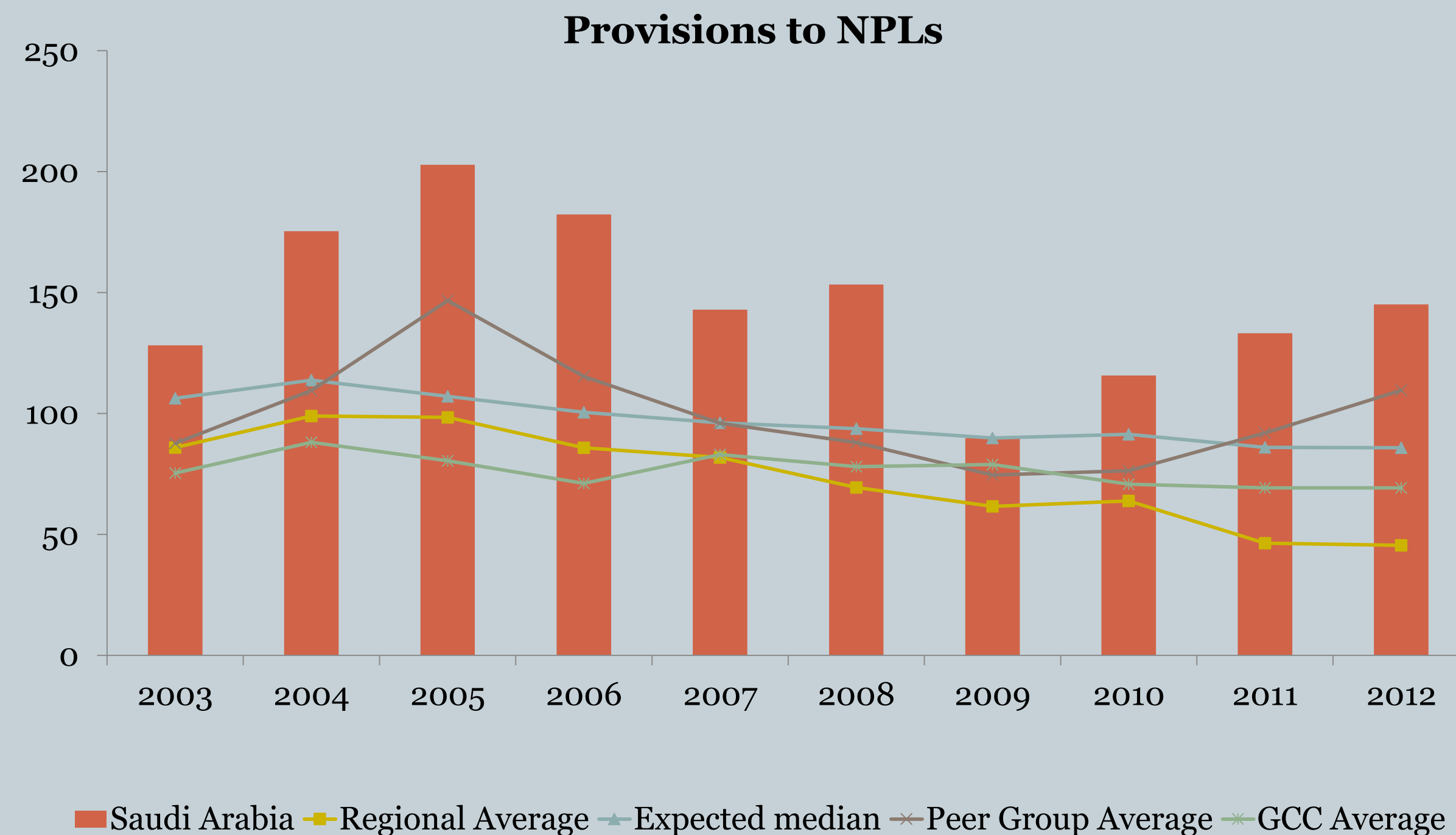
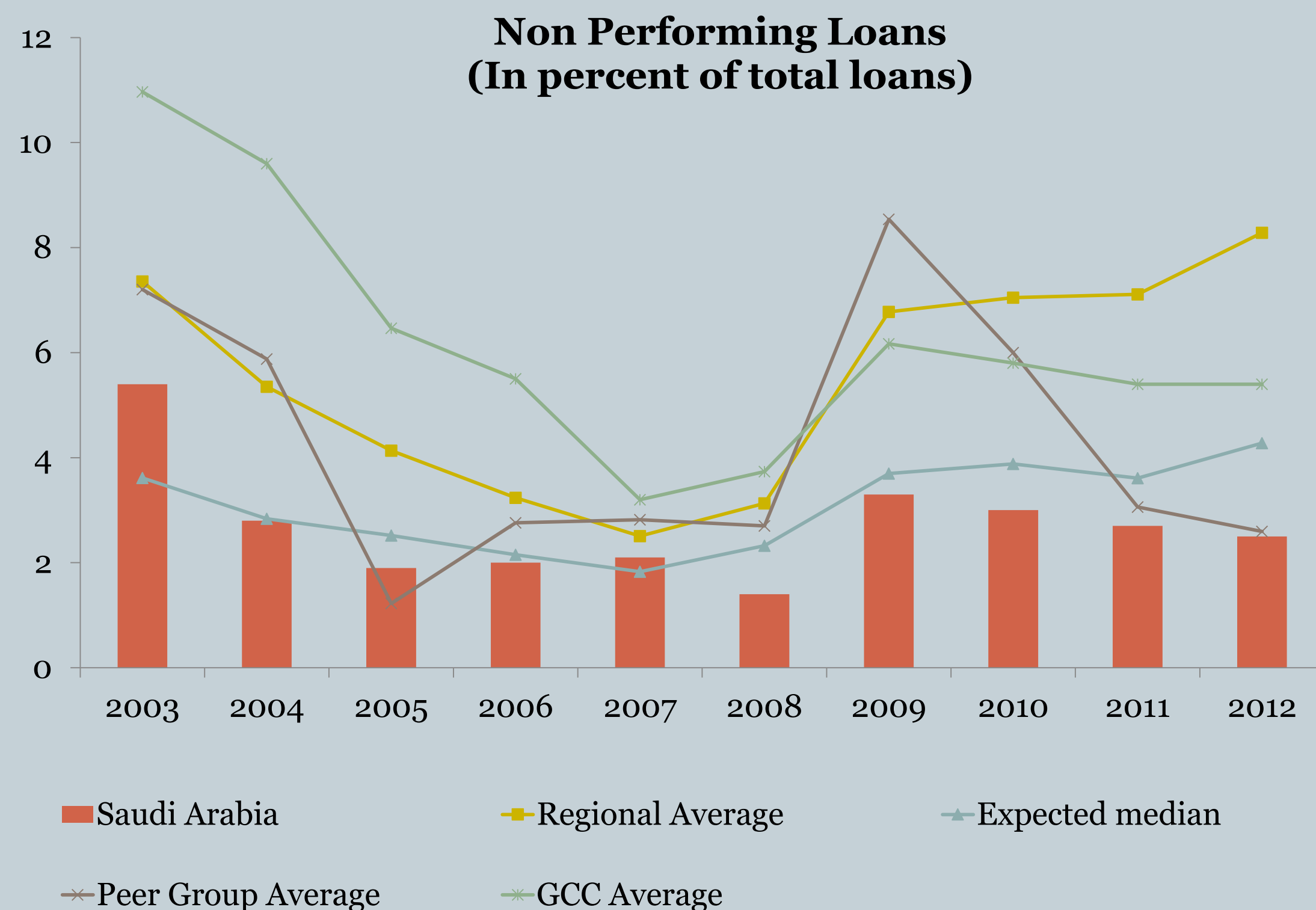


# stability: Liquidity risks are low...



# ...credit risk is small with high provisions...

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# Key Messages and Policy Considerations

- Though the financial system is efficient and stable, it lacks depth and access compared to other countries in the region and oil exporting countries
- Despite availability of credit information and high liquidity, credit to the economy is lagging (supply-demand-or both)?
- Fiscal dominance has an effect on the liquidity in the banking system; and thereby, banks' lending to the private sector
- Stock market activity is dominated by retail investors

# Key Messages and Policy Considerations

- There is a scope to further financial deepening by:
  - Enhancing lending to housing and SMEs, with banks taking a leading role to complement lending by the Specialized Credit Institutions
  - Enhance access to financial services to promote inclusive growth
  - Strengthening the role of institutional investors (mainly the public pension funds) in the capital markets.
  - Developing debt markets (fixed income and Sukuk) to provide additional funding channels (especially for large scale projects) and investment opportunities

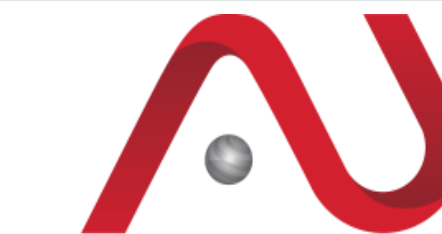
# Key Messages and Policy Considerations

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- Financial deepening is an interlinked and long process:

## *Development and Stability*

- Over the longer term, financial deepening should sustain economic growth and increase the effectiveness of macro economic policies



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THANK YOU!