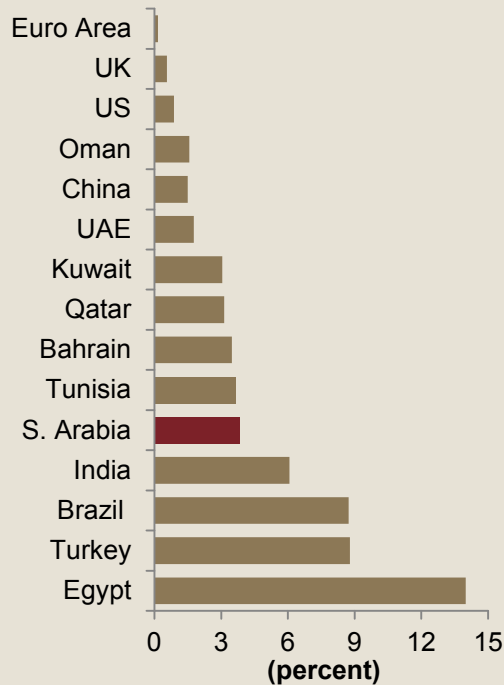




Saudi CPI inflation
(percent)

	Monthly change	Annual change
July 2016	0.1	3.8
June 2016	0.3	4.1

Trading partner inflation rate
(latest, year-on-year change)



Inflation Continues to Slow

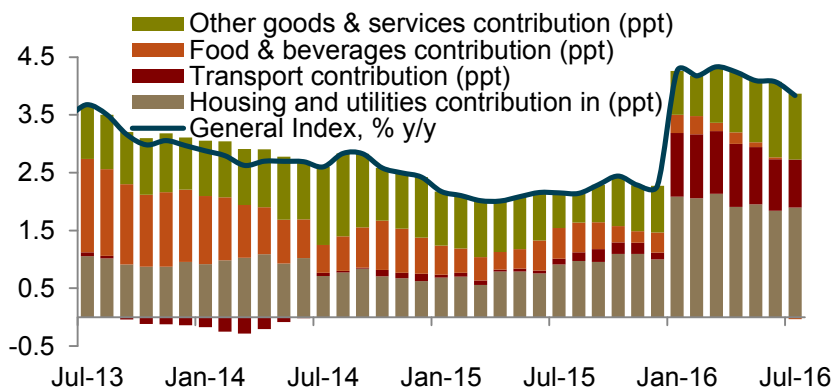
- Saudi CPI reached 3.8 percent year-on-year in July, slowing for the fourth consecutive month.
- Food inflation turned negative, year-on-year for the first time since January 2010.
- Our estimate of the core index showed a notable slowdown as well, reflecting, in part, the subdued level of economic activity so far in 2016.
- Meanwhile, the housing segment remained the largest contributor towards overall inflation.
- The combination of these factors leads use to maintain our forecast for annual average inflation of 3.9 percent for 2016.

The General Authority for Statistics (GAS) has released Consumer Price Index data for July, showing a deceleration in prices to 3.8 percent year-on-year compared to 4.1 percent in June. Food inflation turned negative for the first time since January 2010, while housing inflation remained as the main contributor to overall inflation during July (Figure 1 and Table 1). Our estimate of core inflation, which excludes food and rent and other housing services, also slowed in July, reaching 3.9 percent year-on-year compared to 4.3 percent in June. We believe that subdued economic activity amidst negative growth in broad money supply (M3) has contributed to the recent slowdown in the core index.

The contribution of housing prices to overall inflation rose to 49.4 percent, its highest since December 2011, while core inflation saw its contribution decline to 51 percent, down from 53.6 percent recorded in the previous month.

It appears that persistent deflation in international food prices have finally set into domestic foodstuffs (Figure 2). We believe that the

Figure 1: Inflation has continued to slow since the start of 2016



For comments and queries please contact:

Fahad Alturki
Head of Research
falturki@jadwa.com

Rakan Alsheikh
Research Analyst
ralsheikh@jadwa.com

Head office:

Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

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Persistent deflation in international food prices have finally set into domestic foodstuffs.

Housing inflation recorded an acceleration in July to 7.5 percent.

Nearly all subgroups of the core index posted a year-on-year slowdown in July.

We maintain our forecast for an average annual inflation rate at 3.9 percent for 2016.

recent move by authorities to facilitate imports of food products from various destinations has had a significant impact on domestic foodstuffs, which have turned negative, year-on-year (Figure 3). In monthly terms, food prices were unchanged in July following an average monthly decline of -0.3 percent in the first six months of 2016.

Housing inflation recorded an acceleration in July to 7.5 percent, up from 7.2 percent in June (Figure 4). The acceleration came as the rentals for housing subgroup, the largest contributor towards housing inflation, rose to 3.4 percent year-on-year in July, up from 2.9 percent recorded in the previous month. While this still reflects elevated demand for rentals amidst a shortage of housing units, it is lower than the same period last year (Figure 5).

Nearly all subgroups of the core index posted a year-on-year slowdown in July (Figure 6). Year-on-year inflation for clothing, transport, and furnishings slowed to 4.2 percent, 9.4 percent, and 2 percent respectively. Meanwhile the year-on-year deflationary trend in the restaurants and hotels subgroup continued with -1.6 percent in July. In month-on-month terms, the core index fell by 0.1 percent, with negative changes in the clothing, transport, communication, and restaurants and hotels subgroups. The transport subgroup –which has the third highest weight in the CPI basket– continued to decline for the sixth consecutive month to reach -0.2 percent in July.

While external factors' contribution to inflation will remain subdued, particularly due to a stronger US Dollar and weaker global economic growth, we expect domestic inflationary pressure to be subdued for the remainder of 2016. Domestic price pressures should be alleviated by the negative growth in broad money supply (M3), which is in part due to falling bank deposits (Figure 7). Foodstuffs –with the highest weight in the CPI basket– has been on a decelerating trend since July 2015. We maintain our view that housing inflation will remain the main contributor towards overall inflation, with the increase being driven by strong domestic demand for housing units. The combination of these factors leads us to maintain our forecast for an average annual inflation rate at 3.9 percent for 2016.

Table 1: Main highlights of Saudi CPI inflation

(percent)

	Weights	Month-on-month			Year-on-year			YTD
		Jun-16	Jul-16	Contribution, ppt.	Jun-16	Jul-16	Contribution, ppt.	
Food & beverages	21.7	0.3	0.0	0.0	0.1	-0.1	0.0	-1.8
Housing & related items	20.5	0.1	0.3	0.1	7.2	7.5	1.9	6.5
Tobacco	0.5	0.0	0.0	0.0	20.5	20.5	0.1	20.5
Clothing & footwear	8.4	1.5	-1.0	-0.1	6.3	4.2	0.3	1.6
Home furniture	9.1	0.4	0.0	0.0	2.7	2.0	0.2	1.7
Medical care	2.6	0.0	0.2	0.0	7.4	6.9	0.2	5.7
Transport	10.4	-0.6	-0.2	0.0	10.2	9.4	0.8	9.0
Communication	8.1	0.7	-0.3	0.0	1.5	1.1	0.1	0.7
Recreation & culture	3.5	0.0	0.4	0.0	0.2	0.1	0.0	-0.9
Education	2.7	0.0	0.0	0.0	5.4	5.4	0.1	0.0
Restaurants & hotels	5.7	1.3	-1.3	-0.1	-0.9	-1.6	-0.1	-0.7
Other expenses & services	6.8	-0.3	1.6	0.1	2.5	4.3	0.3	2.9
Core inflation*	57.8	0.4	-0.1	-0.1	4.3	3.9	2.0	2.9
General index	100.0	0.3	0.1	...	4.1	3.8	...	2.7

Note: *Core inflation excludes food and housing inflation and is Jadwa Investment's estimate.



Figure 2: International and domestic food prices

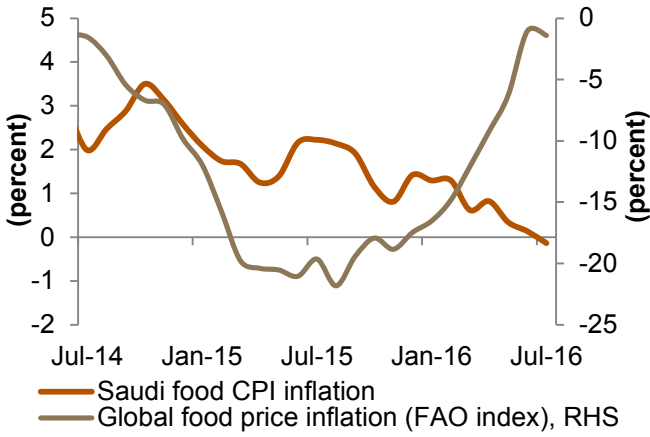


Figure 3: Domestic food inflation

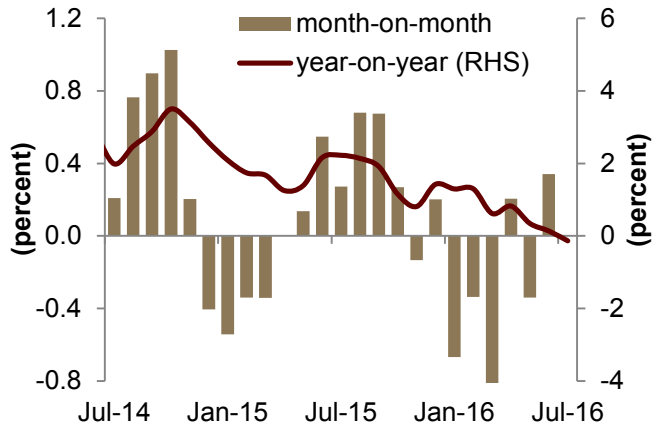


Figure 4: Main components of headline inflation (year-on-year change)

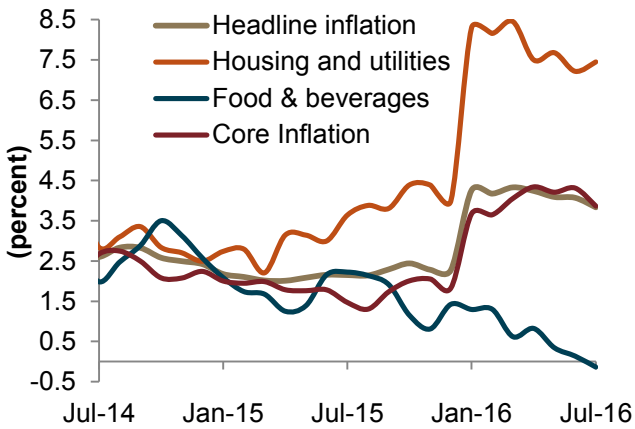


Figure 5: Rentals for housing

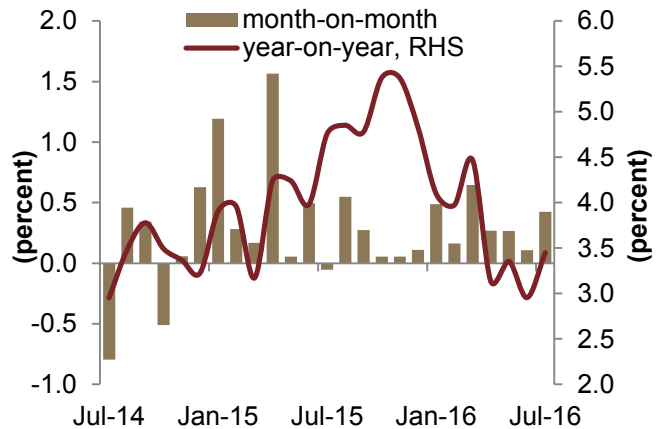


Figure 6: Components of core inflation (year-on-year change)

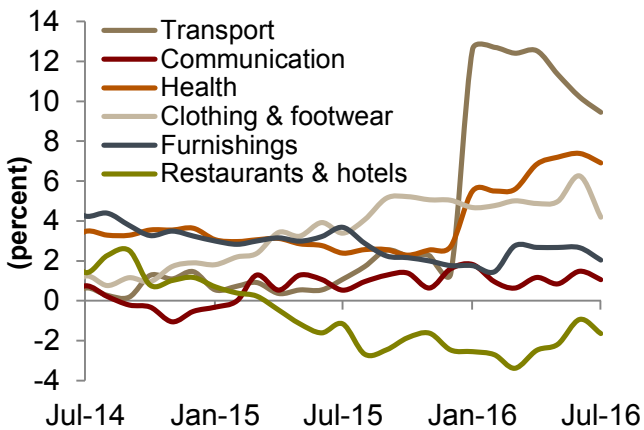
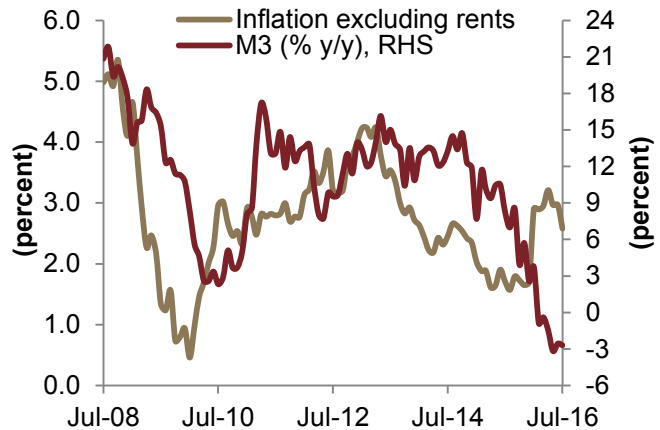


Figure 7: Money Supply (M3) and inflation



Sources: General Authority for Statistics, Saudi Arabian Monetary Agency, Food and Agriculture Organization, Jadwa Investment.



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